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EXECUTIVE OFFICE OF THE PRESIDENT
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THE CHAIRMAN

November 20, 1992

MEMORANDUM FOR DISTRIBUTION BELOW

FROM: MICHAEL J. BOSKIN MJB

SUBJECT: 1993 Economic Report of the President
Chapter 4 -- The Health Care Market

Attached is a preliminary staff draft of Chapter 4 of the 1993 Economic Report of the President. Please let us have your comments in memo form by close of business Wednesday, November 25. CEA welcomes comments and suggestions and finds them extremely helpful in preparation of the Report.

Comments should be delivered to the attention of J.D. Foster, Room 314, Old Executive Office Building.

Please note that the draft is for official use only, should be held closely, and should not be copied.

Attachment

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CHAPTER 4

THE HEALTH CARE MARKET

AMERICANS ARE LIVING LONGER, healthier lives than ever before. Average life expectancy has increased by more than 5 years since 1960. The technology available to physicians in the United States is the best in the world. However, the share of the nation's income that is devoted to health care has been growing rapidly, and more than 33 million Americans lack health insurance. These concurrent developments have been the subject of considerable debate, culminating in the presentation of numerous proposals for health care reform. Proposed reforms differ considerably in their direction, motivation, and scope, from the Administration's market-based reform proposals to proposals for a Canadian-style national health insurance program.

HEALTH CARE IN THE UNITED STATES

The health care sector resembles all other sectors of the U.S. economy in that it supplies a product -- health care -- in response to consumer demand for these services. But the demand for health care is different from the demand for many other goods because in many cases the person purchasing the services does not pay for them directly. Instead, significant proportions of health care services are paid for by government and private insurers. In addition, many people believe that health care is

inherently different from other goods and services. They believe that everyone should be entitled to at least some health care, although they may not believe that people have a similar entitlement to other goods. Together, the prevalence of insurance in health care markets and the special status accorded health care in combination with some basic economic theory go a long way toward explaining the performance of the health care market.

THE HEALTH OF THE U.S. POPULATION

Recent research suggests that improvements in life expectancy in developed countries are not directly related to increases in the number of physicians and hospital beds per capita, nor are they primarily a consequence of increasing utilization of these services. Rather, studies show that improvements in life expectancy are mainly related to changes in behavior and to improvements in medical technology.

Changes in behavior and improvements in medical technology have had a significant effect on American life expectancy, especially since 1960. Life expectancy at birth, which is strongly affected by changes in the infant mortality, rose from 67 years to 72 years for men, and from 73 years to 79 years for women. Furthermore, the life expectancy of older Americans has risen significantly in recent years. Life expectancy at age 65 increased 3 years in the three decades between 1960 and 1990 -- a bigger increase than occurred in the 60 decades after 1900.

<u>Changes in Behavior</u>

Changes in behavior that prevent disease offer great promise as a means of improving American's health. Changes in behavior that prevent health problems are often less costly than treating the health problems when they occur. Many Americans have responded to the possibilities for health improvement through prevention by changing their lifestyles. For example, during the 1980s, the rate of smoking among adults decreased from 33 percent to 26 percent, more Americans exercised regularly, and deaths associated with alcohol abuse declined substantially.

The role of behavior in extending life expectancy can be seen clearly in changes in the incidence of traffic accident mortality. Since 1973, mortality due to traffic accidents has declined by 50 percent -- in part because Americans increased their use of seat belts. In fact, it has been estimated that every one-percent increase in seat belt use saves more than 160 lives per year.

[Changes in workplace behavior have also had an important effect on health. As employment in the U.S. economy has moved away from relatively dangerous heavy manufacturing, mining, and agricultural jobs toward safer jobs in the service sector, the number of work-related deaths in the U.S. has declined substantially, from 14,100 in 1965 to 10,500 in 1990. OMIT??]

Medical Technology

Improvements in medical technology affect life expectancy both by reducing the incidence of disease and by improving the effectiveness of treatments. While over 33,000 cases of polio were reported in 1950, last year not a single case of naturally-occurring polio was reported in the United States. The disease has been all but eradicated because of the development and widespread use of the polio vaccine.

Life expectancy of those with other diseases has also increased in recent years because of improvements in treatment technologies. For example, while childhood leukemia was once almost always rapidly fatal, the long-term survival rate for children diagnosed with leukemia today is about 65 percent.

Improvements in medical care have also led to improvements in the quality of American life. The development of drug therapies for the treatment of ulcers greatly improved the well-being of those with ulcers and virtually eliminated the need for surgery to treat this disease. Similarly, the use of coronary artery bypass graft surgery greatly improves the quality of life of those who suffer from angina.

Role of the Government

For the most part, the health of the U.S. population has improved greatly over this century. However, the picture is not wholly one of improvement. Cures for many existing diseases have yet to be discovered, and new diseases continue to emerge.

For example, the rate of mortality from breast cancer has not improved since 1950 despite the development of new screening methods and new treatment therapies. Since its introduction into the U.S. population in the late 1970s, AIDS has claimed the lives of over 130,000 Americans. In addition, serious discrepancies in health across income and race persist, exemplified by the two-fold differential in the incidence of low birthweight between the children of black women and those of white women.

Government health care spending has been targeted at these problems. The U.S. government spent almost $5 billion in 1992 in funding medical research. More than half of the world's medical research is funded by the United States. The U.S. government spent over $23 billion in 1992 on health care prevention efforts, including $594 million spent on AIDS prevention and $297 million on childhood immunizations. Finally, over 20 percent of federal health expenditures are paid to providers of health care for the poor.

FINANCING HEALTH CARE

Until the mid-1960s, the government's role in the provision and financing of health care was primarily limited to public health prevention and research. An important exception to this pattern was the tax treatment of health care expenditure which is discussed below. In 1960, 56 percent of all expenditures on health care were paid directly out-of-pocket by health care users. The government and private insurers each covered an

additional 21 percent of health expenses. Chart 4-1 illustrates the share of costs borne by individuals, private health insurers (including employers), and the government in 1960 and 1990.

Since 1960, the structure of health care financing in the United States has undergone a major change. By 1990, only 23 percent of health care expenses were paid by consumers out-of-pocket, 32 percent were paid by private health insurers, and 41 percent were paid directly by the government. This change in responsibility for health care costs can be traced to three causes: the expansion of employer-provided benefits, the development of medicare, a government program, that finances care for the elderly and disabled, and the extension and formalization of existing programs to finance care for the poor through the Medicaid program. Health care financing has moved from a situation in which people bore almost all the risk and responsibility for their own health care decisions, to one where most people have relatively little exposure to the cost implications of their health care decisions.

Employer-Provided Benefits

Large numbers of American employers first began offering health insurance benefits to their employees during World War II. During the war and in the postwar period, the imposition of Federal wage and price controls led employers to expand non-wage benefits that were not covered by the controls (of which health care was an example) to attract workers. By 1960, about 13

Chart 4-1 **Expenditures on Health Care, by Source 1960, 1990**

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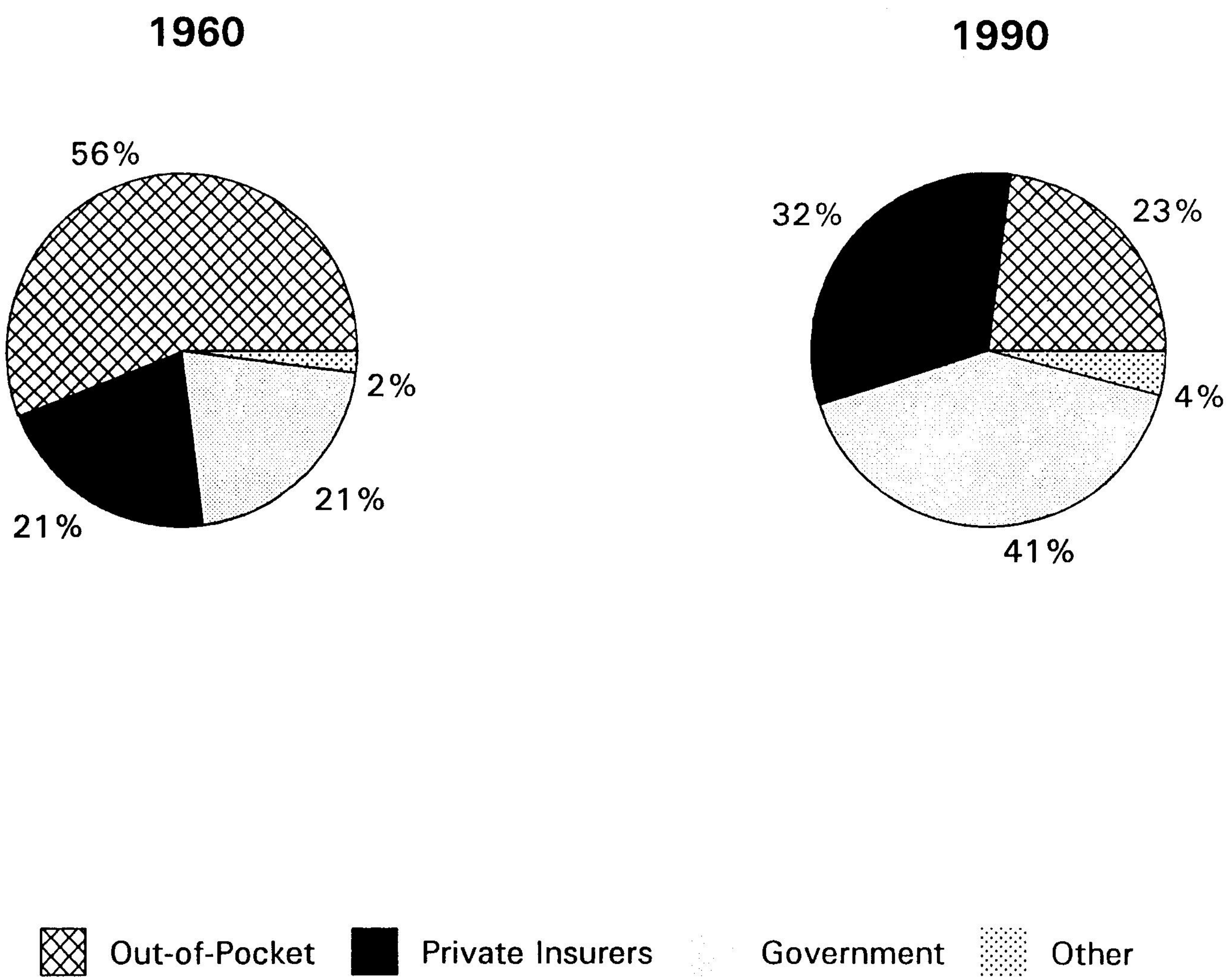

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Source: Health Care Financing Administration.

percent of national health care costs were paid for by private firms. The provision of health insurance by employers was given further encouragement by tax provisions that exempted employer-provided health insurance benefits from employees' taxable income. These benefits are exempt from federal and state income taxes, as well as the employer and employee portion of Social Security taxes. The implication of this exemption is that employees now do not have to pay tax on the share of their compensation that comes to them as health insurance.

[For example, an employee who receives the median pay of $430 a week and who faces a 30 percent tax rate (this figure includes only federal and Social Security taxes) would pay $129 in taxes on her earnings. Her net compensation would be $301 (that is $430 less $129 in taxes). A similar employee who receives pay of $380 in cash each week and a health insurance policy that is worth $50 a week (or $2600 a year) would pay only $114 in taxes. His net compensation would be $316 (that is $380 less $114 in taxes plus $50 as an untaxed benefit). By receiving a portion of his compensation as health insurance, this employee receives $15 more compensation each week. In effect, he is receiving $50 of health insurance but paying only $35 for it. OMIT??]

This preferential tax treatment is effectively a government subsidy for the purchase of the employer-paid portion of employer-sponsored health insurance. The size of the subsidy depends on the individual worker's marginal tax rate: the higher

the tax rate, the greater the subsidy. The greater the subsidy, the more likely workers are to wish to receive part of their compensation in the form of health insurance. Marginal tax rates and the proportion of health expenditures funded by employer payments have both changed over time. In 1965, when the marginal combined tax rate of the median worker (including both Federal and Social Security taxes) was 17 percent, employer contributions for private health insurance accounted for 13 percent of U.S. national health expenditures. By 1980, when the marginal combined rate reached 36 percent, 24 percent of U.S. health expenditures could be accounted for by employer contributions for private insurance. During the 1980s, both the marginal tax rate and the share of health expenditures paid for by employer contributions fell.

The favorable tax treatment of employer-sponsored health insurance also affects the amount of benefits received. It is not surprising that when offered a 20 to 30 percent discount, people buy more of a good. Consistent with this observation, the generosity of health insurance benefits increased during the 1970s and 1980s. For example, the proportion of employees with employer-sponsored plans offering supplementary benefits such as home health care and vision benefits has grown since the mid-1970s.

The tax-favored status of health benefits provides an incentive to channel compensation into health benefits. This incentive is greatest for employees in the highest tax brackets,

because they receive a larger subsidy than workers with lower marginal tax rates. Because the subsidy is proportional to the cost of health benefits, the size of the subsidy also increases as health care costs increase.

By not taxing these benefits as individual income, the government is effectively foregoing revenues that could be used to lower tax rates. In 1993, the exclusion of employer-provided health insurance contributions will result in a revenue loss to the Federal government of $43.1 billion.

MEDICARE

Medicare, a nationwide health insurance program for the population over 65 and for certain disabled people, took effect in mid-1966. There are two parts to the Medicare program: the Hospital Insurance program and the Supplemental Medical Insurance program.

Most Americans over the age of 65 are eligible to receive Medicare hospital insurance benefits. Those who are not yet 65 years old, but who draw Social Security disability benefits, may draw Medicare hospital benefits after a two year waiting period. Most people who suffer from chronic kidney disease are eligible for Medicare hospital benefits regardless of age.

Medicare hospital benefits cover all reasonable costs for 60 days of inpatient hospital care per year with a $652 deductible, which is a maximum annual out-of-pocket payment. Days 61-90 are covered with a daily patient payment of $163. In addition, those

insured through Medicare have a 60 day lifetime reserve for hospitalizations exceeding 90 days, during which they must contribute $326 a day toward the cost of their care. (These deductible and patient payment amounts are for calendar year 1992.) Medicare hospital insurance also provides insurance for skilled nursing facility care, home health care, and hospice care.

Participation in the medical insurance portion of Medicare is voluntary. Anyone 65 or older may purchase medical insurance for a monthly premium of $31.80. This premium covers only about one quarter of the costs of Medicare medical insurance benefits, with the remainder coming from general tax revenues.

Medicare medical insurance covers physician services, laboratory and other diagnostic tests, and other outpatient services. Medicare medical insurance generally pays 80 percent of the approved amount for covered services in excess of an annual deductible of $100. The remaining 20 percent is the responsibility of the beneficiary.

Many Medicare beneficiaries purchase additional private insurance, called Medigap insurance, to cover deductible and patient payment amounts that are not paid by Medicare. In 1990, 76.6 percent of Medicare beneficiaries had medigap insurance. 44 percent of persons with medigap insurance purchased such insurance directly. An additional 39.6 percent are retirees who receive medigap coverage through their former employers. For poor Medicare recipients, another government program, Medicaid

(discussed below), provides this additional coverage. The least generous medigap insurance permitted to be sold commercially covers all hospital patient payments beyond the deductible and a portion of the medical payments that would otherwise be the responsibility of the Medicare beneficiary. Consequently, purchasers of medigap insurance have little out-of-pocket exposure for hospital and physician bills. New Medicare beneficiaries (those who have just turned 65) are legally guaranteed the right to purchase medigap insurance regardless of their health status, although the rate that they are charged may vary with health status.

MEDICAID

Medicaid is a Federal-State matching entitlement program that provides medical benefits to low-income persons who are aged, blind, disabled, members of families with dependent children, and to certain additional pregnant women and children. Eligibility for Medicaid has traditionally been tied to the actual or potential receipt of cash benefits under the Aid to Families with Dependent Children (AFDC) program or the Social Security program. In 1986, Congress extended Medicaid coverage to pregnant women and children under 6 with family incomes below 133 percent of the Federal poverty level.

For aged persons whose incomes are below the poverty line and who receive Medicare benefits, Medicaid pays the patient out-of-pocket portion of physician and hospital expenses.

Medicaid also covers long-term nursing home care. About one-quarter of all Medicaid expenses in 1987 were for nursing home care for the population over 65.

Each State administers its own Medicaid program, consistent with certain eligibility requirements established by the Federal government. The Federal government then shares the expenses of the State program with the State. The Federal government pays 50 percent of the State's administrative expenses. It also pays a share of the medical expenses according to a matching formula which reimburses poorer States at higher rates. The Federal share of Medicaid costs ranges from a low of 50 percent for richer States to a high of 83 percent for poorer States.

In 1990, 25.3 million persons received Medicaid benefits, of which 6.9 million qualified through the Social Security program for the poor aged, blind, or disabled, and 17.2 million qualified through the AFDC program for families with dependent children. However, the aged, blind, and disabled, who account for only 27 percent of the caseload, received about 70 percent of the outlays. Dependent children accounted for 14 percent of Medicaid outlays. Beneficiaries under Medicaid are not required to contribute to the cost of their care.

THE PROVISION OF HEALTH CARE SERVICES IN THE UNITED STATES

The industry that provides health care has changed relatively little since 1960 even as the financing of that industry has undergone revolutionary changes. Hospital care (a

category that includes all services billed through a hospital, including the services of some physicians, such as medical residents and radiologists) consumes the largest part of each health care dollar, about 38 cents of every health care dollar in 1990, an amount that is only slightly above the proportion consumed in 1960. Physician services continue to be the second most important contributor to costs, accounting for 19 cents of every health care dollar. Table 4-1 provides a description of the U.S. health care system.

TABLE 4-1

- Over 9 million people are employed by the health services industry. By contrast, fewer than 1 million people are employed in the automobile manufacturing industry.
- There are nearly 600,000 active physicians in the United States today.
- There are approximately 6,000 hospitals in the United States, and over one million hospital beds.
- In 1989, the occupancy rate of non-Federal hospitals providing short-term care was 66 percent.
- In 1990, the average number of physician contacts per person was 5.5.
- About one in every ten Americans had a hospital admission in 1990 -- over 10 percent of these were for

maternity care. The average admission lasted 6.7 days.

- Health expenditures per capita average $2566 in 1990.

Even at a more disaggregated level, the provision of health care services in the United States remained relatively unchanged until the late 1970s. Independent non-profit hospitals provided services to patients and were reimbursed for the costs of these services by those patients who had public or private insurance. The costs incurred by patients without insurance who could not pay their own bills were passed along either to paying patients in the form of higher charges, or to other participants in the hospital market, such as hospital employees. Almost all physicians were in private practice, seeing their own patients and charging them fees for the services that the physicians had provided.

Economic theory suggests that if patients paid for all of their own care out-of-pocket, costs under this structure would likely have remained quite stable. When hospitals or physicians were deciding whether to keep patients in the hospital longer, order more tests, or perform more procedures, they would have to keep in mind that their patients would have to pay for the care that they received. However, once patients had insurance for medical care services, hospitals and physicians who wanted to provide the best possible care to their patients had less reason to worry about the cost of the services that they recommended. Physicians had no reason not to recommend services up to the

point where further treatment would provide absolutely no additional benefits, even if the benefits obtained from the last units of treatment were outweighed by the cost of providing the treatment.

Institutional Innovation: Retrospective and Prospective Reimbursement

Under retrospective reimbursement -- payment of physicians and hospitals for the costs of the services that they had provided after those services were delivered -- physicians and hospitals had little incentive to limit their use of services for insured patients. As health care costs rose through the 1970s and 1980s, insurers began to experiment with alternative reimbursement strategies that would give providers of care incentives for both quality care and cost control. For outpatient services, the major innovation was the introduction of "capitation-based" reimbursement and direct review of the utilization of medical and hospital services through "coordinated care" programs. In coordinated care programs, insurers co-ordinate and manage the care provided by doctors and hospitals.

Under capitation-based reimbursement, physicians receive an annual payment for each patient in their care, regardless of the services that patient uses during the year. By 1990, 33 million Americans received care from physicians paid on a capitation basis, over 5 times as many as had 15 years earlier. In the

conventional fee-for-service market, insurers responded to rapidly rising costs by reviewing physician behavior more closely. Insurer oversight has taken diverse forms, including case-management, or increased monitoring, for more costly cases (used by 67 percent of firms offering health insurance in 1991) and requirements that patients seek a second opinion before undergoing surgery (used by 49 percent of such firms in 1991).

These innovations, which have occurred largely in the private insurance market, have reduced medical care costs without any evidence of negative effects on patient health. In fact, capitation-based payment can give physicians an incentive to invest in preventive care, because they benefit financially when their patients remain healthy.

In an effort to control the rising cost of hospital care, which makes up the bulk of Medicare payments, the Federal government in 1983 replaced the existing retrospective payment system for hospital costs with a prospective payment system that is analogous to the capitation scheme used in coordinated care. A Medicare patient admitted to hospital is now classified as belonging to one of 470 diagnostic related groups (DRGs). There is a single payment level for each DRG (with some regional and hospital-type variation) based on the average cost of treating a patient in that DRG. No matter what services are provided to a patient classified in a particular DRG, the hospital's Medicare reimbursement is (in most cases) equal to the level specified by the DRG. Hospitals that can provide care at lower than average

cost profit from this system.

The implementation of the DRG system affected incentives at the hospital level. Patients' length-of-stay in the hospital fell significantly. The cost of hospital care paid for by Medicare was estimated to have fallen 20 percent relative to what it would otherwise have been. Finally, there is substantial evidence that suggests that implementation of the DRG system has not reduced the quality of care provided to Medicare patients.

These payment innovations provide a sounder set of incentives for health care providers. They have moderated health care cost growth in the United States and they have been viewed as a model by more heavily regulated health systems abroad. In fact, the United Kingdom has been experimenting with the introduction of coordinated-care systems, and Germany and Canada have been developing versions of DRGs.

BOX 4-1: Coordinated Care

The term coordinated care has been used to describe a variety of payment structures and health care provider arrangements that are characterized by increased coordination and management of health care services. The best-known form of coordinated care arrangement is the Health Maintenance Organization (HMO). HMOs use a defined set of health care providers to care for a group's health care. The HMO is paid by its members on a capitation basis (sometimes with small copayments for physician visits), which means that a specified amount of money is paid for each individual enrolled, regardless of services rendered.

The most popular alternative coordinated care organization is the Preferred Provider Organization (PPO). A PPO contracts with a group of providers who then charge PPO members according

to a previously negotiated fee schedule. PPOs usually incorporate programs to monitor the use of services, in order to ensure that physicians do not offset lower fees with increased volume.

Coordinated care programs have been shown to reduce costs while maintaining the quality of care. In some studies, reductions in the cost of care, relative to standard fee-for-service plans, were as great as 30 percent.

Although there has been considerable growth in the use of coordinated care in the private sector, growth has been much slower in the public sector. Medicare began entering into contracts with HMOs in the mid-1980s. Because Medicare beneficiaries have few incentives to join HMOs, however, very few have chosen to do so. Fewer than ten percent of Medicaid beneficiaries currently receive care through coordinated care arrangements.

SUMMARY

- Improvements in technology and healthier behavior have led to significant improvements in the average health experienced by Americans. Americans are living longer, healthier lives, and no longer have to worry about many life threatening illnesses.
- Government's share of total health costs has increased.
- The share of out-of-pocket spending in total health expenses has been falling.
- In response to cost increases, there have been important changes in the provision of care, moving away from fee-for-service, retrospective reimbursement of independent providers to prospective/capitation based reimbursement of networks of providers.

THE COST OF HEALTH CARE

Health care costs have been increasing very rapidly over the past three decades, in the United States as well as in other developed countries. This rapid rise in costs has been the source of much concern and has spurred numerous changes in the provision of health care in the United States.

U.S. HEALTH CARE EXPENDITURES

Chart 4-2 describes the pattern of per capita spending on health care since 1960. The figures in Chart 4-2 are adjusted for inflation using the non-medical care component of the consumer price index. The adjusted figures indicate the amount of 1990 non-medical care goods and services foregone in exchange for health care.

As Chart 4-2 illustrates, real spending on health care has been rising since 1960. Increases during the 1960s could be attributed to the expansion of health insurance benefits through the establishment of Medicaid and Medicare in the mid-1960s. But health care spending has continued to increase since 1966.

Studies that examine patterns of health care spending across countries show that the share of income spent on health care usually rises as income rises. These results suggest that as incomes rose between 1960 and 1990, health care spending would likely have risen at least as quickly. Chart 4-3 displays the pattern of national health care costs as a proportion of national income. The Chart shows that health care spending rose in

Chart 4-2 **Per Capita Health Care Expenditures**

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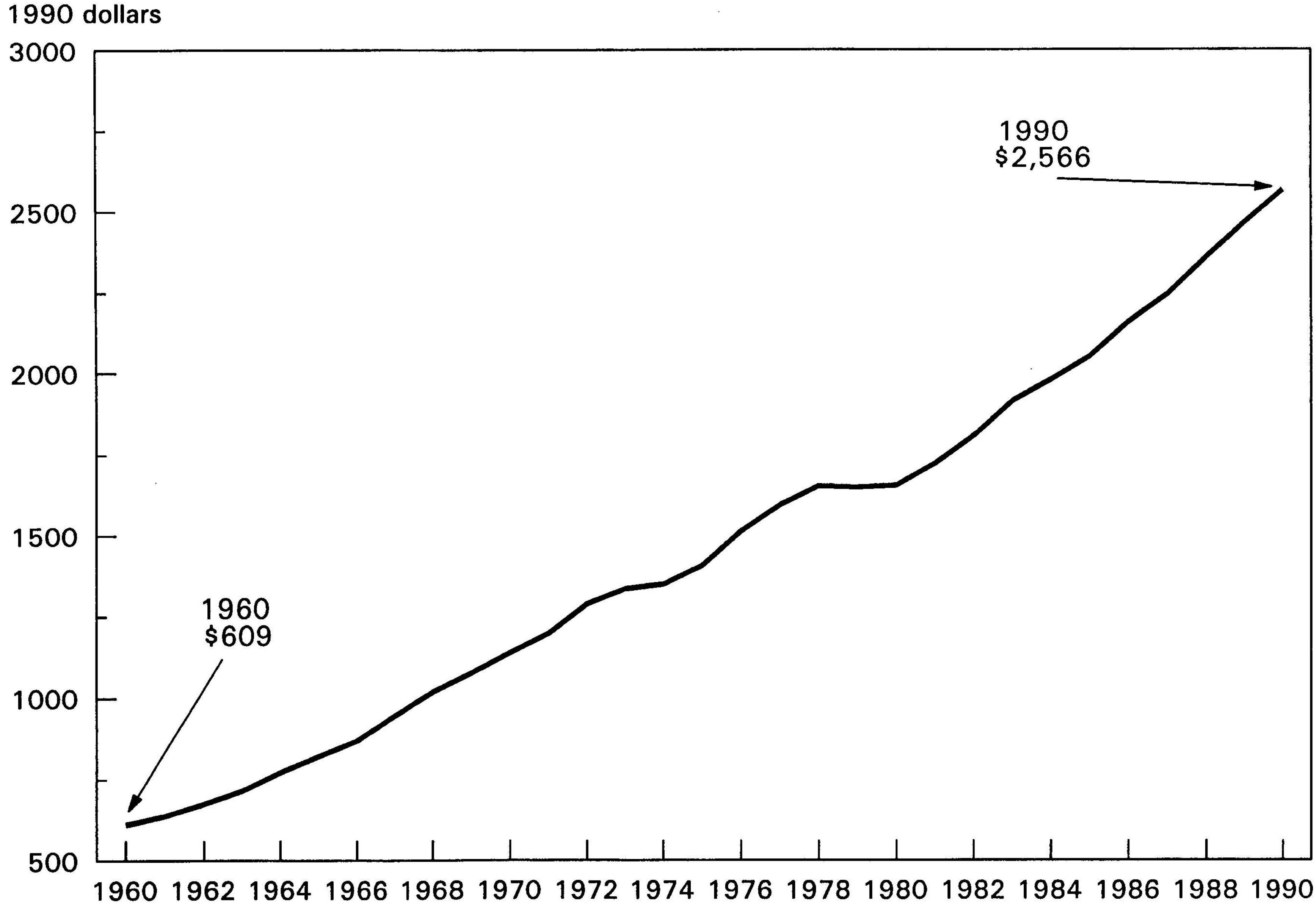

Note: Expenditures deflated by non-medical care component of CPI-U.
Source: Department of Labor, OECD.

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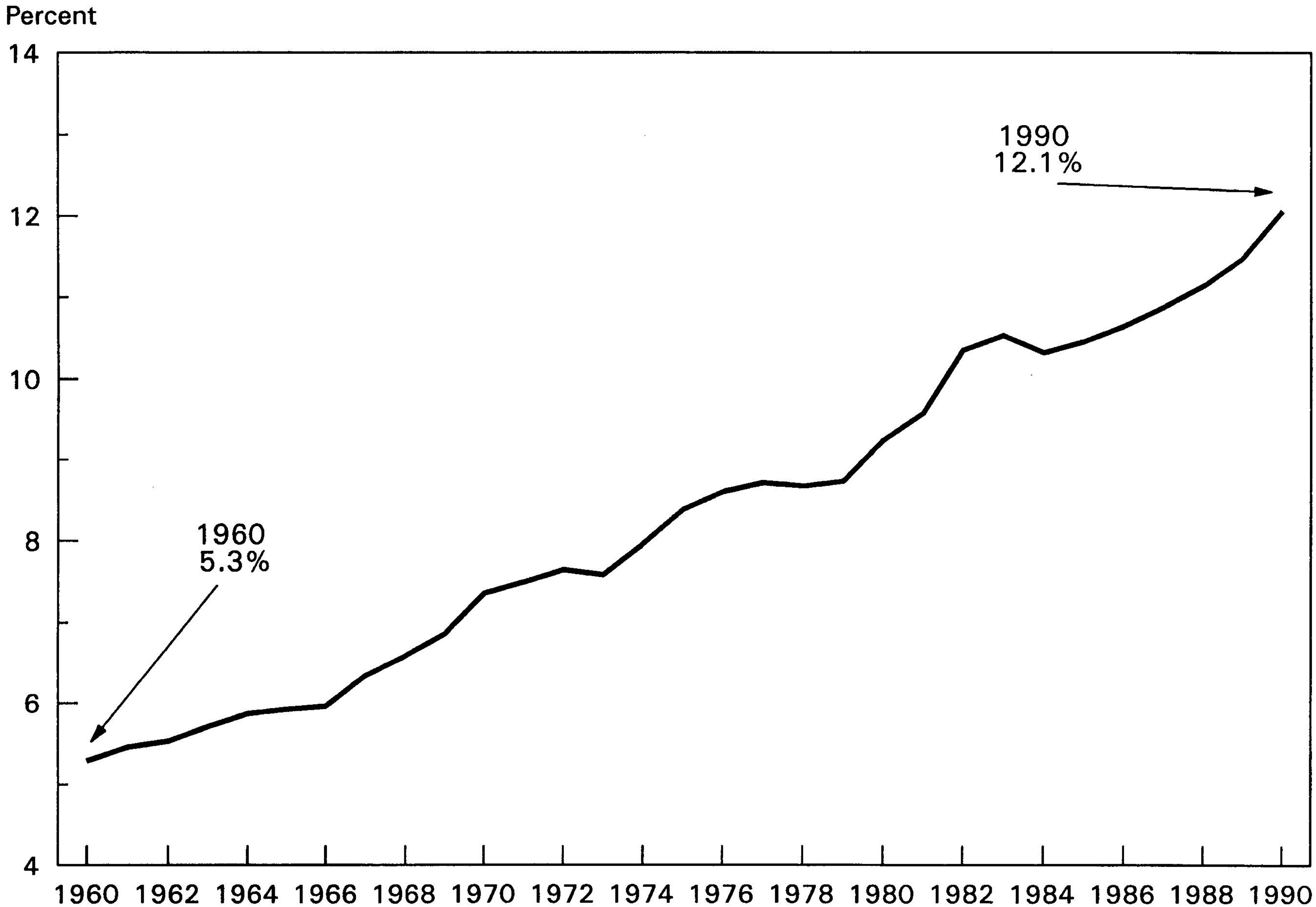
Chart 4-3 **Health Care Expenditures as Percent of GDP**



Note:.
Source: Department of Commerce, OECD.

proportion to U.S. GDP from 5.3 percent to 12.2 percent between 1960 and 1990.

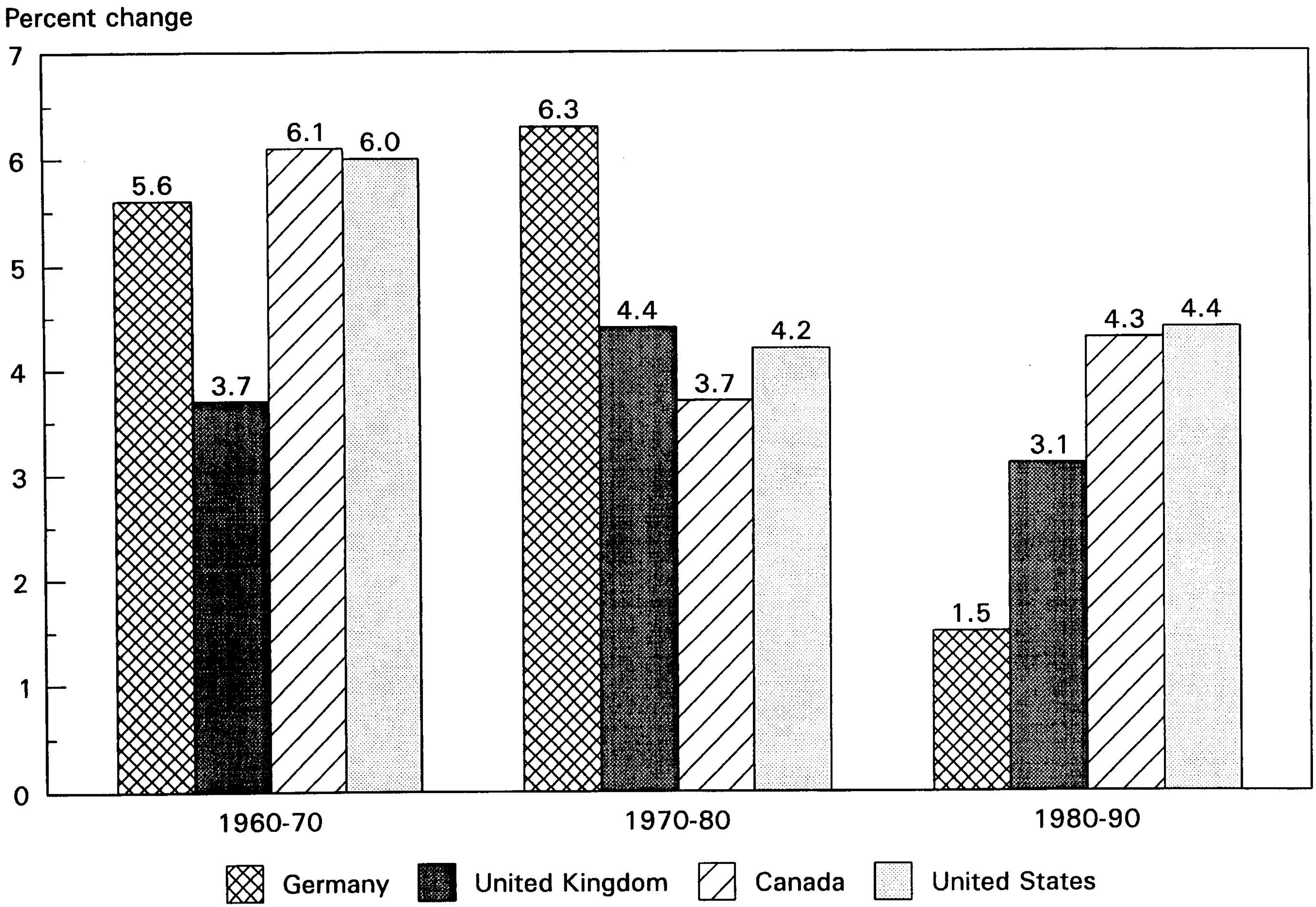
Although health care spending did rise as income rose over the 1960-1990 period, a comparison of Charts 4-2 and 4-3 shows that the year-to-year fluctuations in real per capita health care spending were smaller than the year-to-year fluctuations in spending as a fraction of national income. This is because spending on health care is not greatly affected by short-term changes in economic conditions. Thus, the share of health care in national income rises during recessions, while in periods of prosperity the share of health care in national income may fall. Over short periods of time, changes in the percentage of national income that is spent on health care are often attributable to changes in national income rather than to changes in the pattern of health care spending.

HEALTH CARE IN OTHER DEVELOPED COUNTRIES

Like the United States, most developed countries experienced large increases in health care spending between 1960 and 1990. Chart 4-4 describes changes in real per capita expenditures on health care in the United States, Canada, Germany and the United Kingdom between 1960 and 1990. The growth rates in Chart 4-4 were computed using national currency overall gross domestic product price indices (including medical care) to adjust for general price inflation.

As Chart 4-4 shows, health care spending has increased

Chart 4-4 **Annual Growth Rates of Real Per Capita Spending for Selected Countries** DRAFT



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Note:
Source: OECD.

rapidly in all four countries since 1960. In Germany, spending increased most rapidly during the 1960s and 1970s; the rate of growth slowed substantially in the 1980s. In Canada, the United Kingdom, and the United States costs increased rapidly in all three decades.

Per capita health care spending in the United States has historically been higher than per capita spending in other countries. Health care spending per capita is much higher in the United States than in Germany, Canada, or the United Kingdom today, but the ratio of U.S. expenditures to expenditures in these other countries has held quite steady.

The rapid growth in health care spending in the United States, Canada, Germany, and the United Kingdom is even more surprising because these four countries have very different systems of health care financing and health care provision.

<u>Canada</u>

Since 1971, all Canadians have been covered by public health insurance plans administered by the Canadian provinces. In Canada, it is illegal to sell private insurance for services provided by the public plan and participating physicians and hospitals may not accept out-of-pocket payment for services covered by the public plans. While provinces differ in the methods they use to raise funds for health care, most funding comes from general tax revenues, collected through income, sales, and payroll taxes.

Canadian physicians are paid by the provincial governments on a fee-for-service basis using a fee schedule negotiated between the provincial governments and physician associations. There have been very substantial increases in the utilization of physician services in Canada since the introduction of public health insurance. Attempts to cut physician costs by limiting the fees that physicians can charge have been thwarted by these continuing increases in utilization.

Hospitals in Canada are reimbursed using annual lump sum budgets (called global budgets) that do not depend on utilization. New hospital equipment cannot be purchased and operated by these hospitals without government approval. Most types of high technology equipment are less commonly available in Canadian hospitals than in U.S. hospitals. The global budget reimbursement system and the restrictions on technology purchase have led to waiting lines for some hospital services.

<u>Germany</u>

The German health care system consists of approximately 1,200 not-for-profit health insurers called sickness funds in which low and middle incomes are required to participate. Some higher income individuals (less than 10 percent of the population) participate in highly regulated private insurance programs instead of the sickness funds. Out-of-pocket payments are very low. Most funding comes from payroll taxes. General tax revenues are used to fund coverage for the non-working poor.

German physicians belong to regional associations which negotiate a lump sum budget for physician services with the sickness funds. Individual physicians are reimbursed by the physicians' associations on a fee-for-service basis. Hospitals are paid operating costs that are negotiated between the hospitals and sickness funds. These operating costs are used to pay salaries to hospital-based physicians.

Germans have many more physician visits per year than do Americans, but the average physician visit is much shorter. Germans also spend more days in the hospital, on average, than do Americans. However, the ratio of hospital staff to patients is much lower in Germany than in the United States and less high technology equipment is available in Germany.

United Kingdom

In the United Kingdom, the National Health Service (NHS) both finances and delivers health care. All residents are eligible to receive care through the NHS. A small, but growing, private insurance market also exists. The NHS is primarily financed out of general revenues. There are very low patient payment requirements for a limited number of services, such as drugs.

Almost all physicians are employed by the government, which also owns most of the hospitals. Office-based primary care physicians who are part of the NHS are paid on a capitation basis, adjusted according to the age of their patients. All

office-based NHS physicians are general practitioners. They may refer patients to salaried specialists who work out of hospitals.

Costs are much lower in the United Kingdom than in other developed countries. However, British health care is characterized by a much lower level of high technology and fewer physicians per capita than Canadian, German, or American health care. Furthermore, there are long waiting lines for many high cost, nonemergency procedures and physician visits are very short.

<u>As health care costs continue to increase under each of these models, each of these countries is considering health care policy reform.</u> Policy reform proposals in many of these countries incorporate such features of the U.S. health care system as managed care (in Canada and the United Kingdom), DRGs (in Germany and Canada), and patient co-payments (in Germany).

WHERE HAS THE MONEY GONE?

Although overall health care costs in the United States have been rising rapidly since the mid-1960s, the costs of different components of health care services have risen at different rates. Chart 4-5 illustrates the annual rates of growth in different components of health care costs in the 1960-90 period. The chart relates these growth rates to the average share of out-of-pocket expenditures over this period for each service. The rates of cost growth have differed by type of care: hospital and medical costs have grown faster than dental and pharmaceutical costs.

Chart 4-5 **Growth Rates of the Cost of Health Care Components and Out-of-Pocket Shares**

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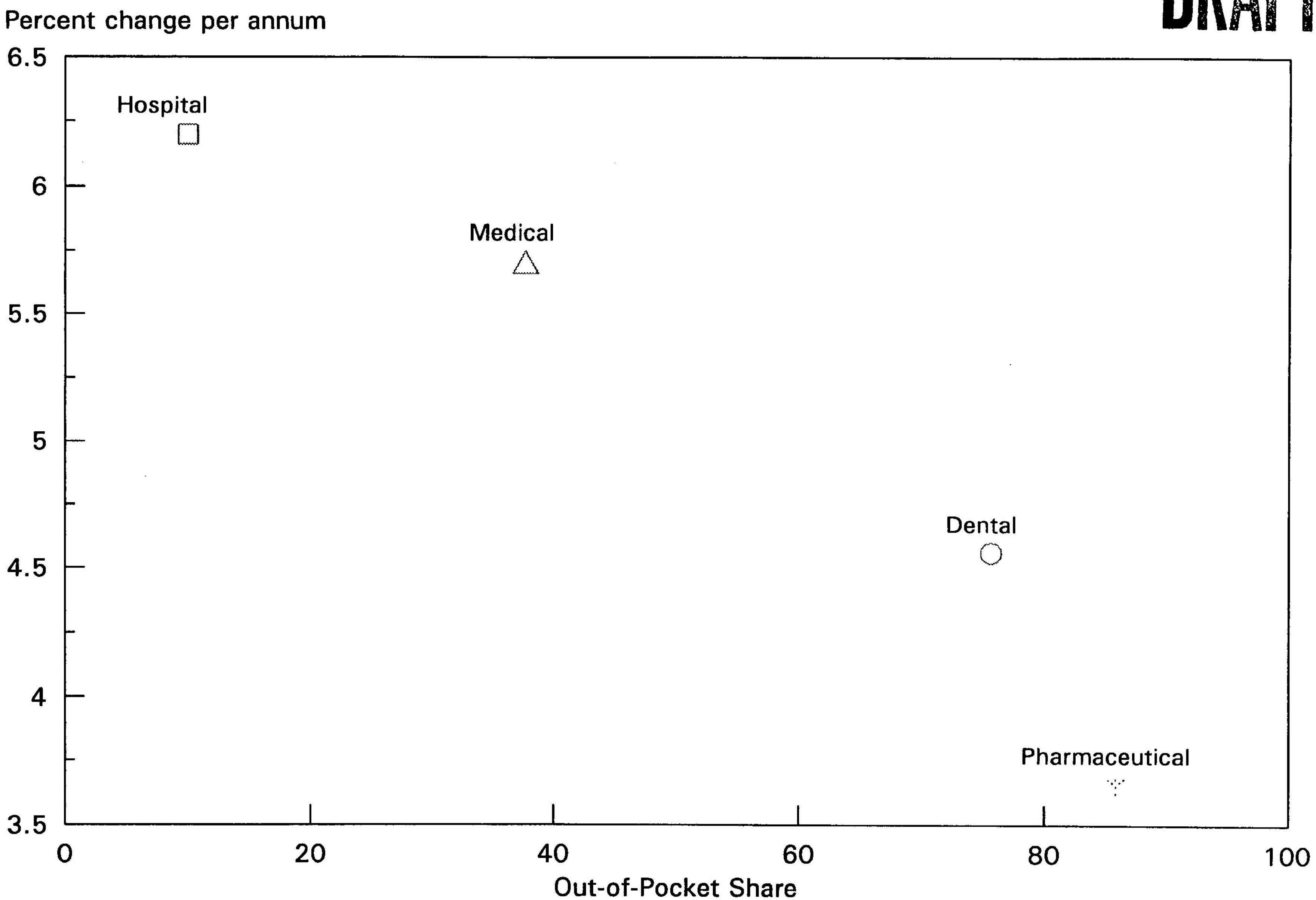

Note:
Source:

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Although not reflected in this chart, the rates of cost growth for different components have changed during the 1960-90 period, reflecting demographic changes, changes in the source of funding for different services, and regulatory interventions such as the imposition of wage and price controls on hospitals in the early 1970s and the introduction of the prospective payment system in the 1980s.

The chart suggests that components of health care spending with higher proportions of costs covered by out-of-pocket payments, such as dental services, have shown relatively slower growth in costs over this period than those components with low proportions of cost covered by out-of-pocket payments. While early health insurance plans provided the most complete coverage for hospital care, the share of out-of-pocket payments in the costs of other health care services has also began to fall as insurance coverage has become more generous. Along with this decline, the rate of increase in the cost of these components of health care expenditures has become more similar to that of hospital and physician services.

SUMMARY

o Spending on health care has been rising steadily since the 1960s, both in absolute terms and as a share of national income

o Spending on health care has also been rising in other developed countries. The rate of increase since the 1960s

has been quite similar among countries, although the time patterns of the increases in spending have varied.

- Costs have risen more slowly in those sectors of health care where out-of-pocket payments have been greatest.

WHY ARE HEALTH CARE COSTS INCREASING?

The experiences of the past three decades in the United States and in other countries suggest that costs may increase because of changes in the cost of care, in the quantity of care consumed, and in the quality of that care.

PRICES AND QUANTITIES OF HEALTH CARE

The Health Care Financing Administration (HCFA), the Federal Government agency that administers Medicare and Medicaid, has developed a price index for personal health care expenditures that measures the cost of all health care services regardless of who pays for them. By dividing total spending on health care by this index, one can measure the number of units of health care services that are consumed. These "units" represent a composite measure of quantity that includes different kinds of services such as physician visits, hospital days, and drug purchases. Changes over time in the price index include two components: changes in the economy-wide rate of inflation and changes in the price of health care services that cannot be attributed to economy-wide inflation. In order to separate changes in the cost of health care from changes in the price level, changes in the

health care index are subtracted from changes in an economy-wide price index. Table 4-2 provides measures of changes in total health care expenditures and divides these changes into changes in economy-wide prices, changes in health care prices in excess of economy-wide inflation, and changes in the quantities of health care consumed.

Table 4-2: Average Annual Percent Change in
Personal Health Care Expenditures Per Capita: 1960-1990

	1960-70	1970-80	1980-90
Expenditures on health care per capita	9.2	11.9	9.2
Health care prices including inflation	3.9	7.8	6.9
Quantities of health care per capita	5.1	3.8	2.2
Health care prices net of inflation	1.7	1.6	2.3

The price index for health care expenditures, like other price indices, is constructed by examining the cost of a basket of commodities or services over time. In the case of the personal health care expenditure index, this basket includes hospital days, physician services, drugs, as well as other

health-related products. It is important to note that these categories are quite broad. The price index does not reflect the price of a particular service provided by a hospital or physician. Rather, it reflects changes in the overall price of commodities or services within a category. Thus, changes in the quality or intensity of the commodities or services provided will usually not be taken into account by the price index. Instead, an improvement in quality will appear as though it were an increase in price. For example, total expenditures for a hospital day would increase if the number of nursing visits associated with that hospital day increased. While such a change would imply an improvement in the quality of the hospital day, it would appear as an increase in the health care price index in the decomposition of costs into prices and quantities.

BOX: An Alternative Way to Measure Changes in Health Care Costs

Measures of the cost of health care often fail to account for changes in the quality or intensity of health care service provision. This problem is common to many service industries where consumers are interested in purchasing a service, not the ingredients for that service. Consumers are interested in purchasing a cure for their ailment, not the particular combination of diagnostic tests and treatments that are used to cure the ailment.

An alternative method for measuring health care costs, proposed in 1968 by Dr. Ann Scitovsky, suggests a more appropriate, though computationally complex, way to measure changes in health care. Scitovsky suggested that economists measure the cost of treating a particular ailment over time. For example, she compared the cost of treating an ear infection in 1971 to the cost of treating an ear infection in 1981. (The cost fell.) Further, she suggested, the costs of treatment should be

adjusted to reflect the changing probability of achieving a cure for the ailment.

Why isn't this more appropriate method of measuring health care costs in wider use? One reason is that it is computationally very difficult to measure the full cost of treating an ailment. Moreover, we also know that even this method does not fully capture changes in medical technology. Important advances in health care have not only improved the technology for treating a disease, but in many cases reduced its overall incidence. These improvements may also improve the quality of life of individuals, even if life expectancy does not change. At the same time, there are diseases today that did not even exist in 1960. Even Scitovsky's modified method does not fully capture the effect on costs either of improvements that reduce the incidence of disease or of new diseases.

RECENT INCREASES IN HEALTH CARE COSTS

Expenditures on health care have risen continuously since the 1960s, both because of increase in health care prices and because of increases in health care quantities. In the 1980s, health care spending (net of economy-wide inflation) grew more slowly than in the preceding two decades. Growth was split evenly between increases in units of health care spending (2.3 percent per year) and changes in the health care price index (2.2 percent per year). Concurrent increases in both price and quantity would seem to go against economic theory. In fact, these measured quantity and price increases include changes in the type, intensity, and quality of health care provided.

Growth in units of health care services occurred mainly because of increased use of outpatient and physician care. After the implementation of prospective payment for hospitals in 1983,

the rate of increase in hospital utilization slowed considerably. However, prospective payment covers services provided by hospitals on an inpatient basis only. Outpatient services for Medicare continue to be paid on a retrospective fee-for-service basis. This payment asymmetry gives hospitals considerable incentives to move procedures from an inpatient setting to an outpatient setting. Since outpatient care is generally less costly than inpatient care, this change had the effect of reducing health care costs below what they would have been in the absence of prospective payment.

Providers appeared very responsive to the incentives provided by this new payment system. In response to the relatively more generous reimbursement for outpatient services, there has been a rapid increase in the utilization of these services. For example, in 1980, 16.4 percent of surgeries in short-stay hospitals were done on an outpatient basis. By 1990, 48.7 were done on an outpatient basis. The potential of the health care sector to respond in this flexible and rapid way to changing incentives is a feature that must be considered in developing health policy.

PRICE INCREASES IN THE 1980s

The 1980s saw the most rapid annual rate of increase in health care prices of the past three decades. Price increases occurred in all components of health care spending. These price changes occurred both through changes in the technologies and in

the cost and type of labor used to produce health care.

In many industries, cost increases occur when the availability of supplies of the resources that are needed in production decline. In the health care market, the main resources that may be available only in limited supply are highly-skilled professionals. As the case of the nursing market described below suggests, short-term shortages in skilled personnel can occur and can cause costs to rise. However, such short-term shortages are unlikely to lead to continuing cost increases.

Physicians in certain specialties may also be in short supply. If shortages cause the price of their services to rise, new physicians will have an incentive to be trained in these specialties and the shortage will be alleviated. However, restricted supplies of physicians can persist over time because the total number of physicians who may be newly-licensed in the profession in any year is limited by the medical profession. Nonetheless, studies suggest that the ability of the medical profession to limit entry into the market and thus drive up prices has declined over time.

Nursing Costs in the 1980s

At the end of the 1970s, nursing wages were quite low, relative to those in other occupations requiring similar levels of education. These low wages discouraged qualified applicants from entering nursing school. Between 1983 and 1987, nursing

school enrollments fell 27 percent. In an effort to attract more nurses, hospital increased real nursing wages. Between January 1980 and January 1990, while real average hourly earnings for all private sector workers fell 6 percent, hourly earnings of private hospital employees rose 23 percent (note that these hourly earnings figures do not include the value of non-wage compensation). Among all hospital employees, registered nurses received the largest pay increases. At the same time, the reductions in length of stay and increased use of outpatient surgery that accompanied prospective payment meant that patients who were admitted and kept in hospitals were, on average, sicker than in 1980. Hospitals had to increase the number of highly skilled registered nurses that they employed in order to maintain the quality of service.

Medical Technology in the 1980s

Changes in medical technology also had an important impact on health care costs in the 1980s. Between 1980 and 1990, for instance, the number of computerized tomography (CT) scans performed in short-stay hospitals in the United States increased by 400 percent. The number of hospitals with magnetic resonance imagery equipment rose by 19 percent between 1989 and 1990 alone. Many of these new technologies also proliferated in non-hospital settings.

Physician Costs in the 1980s

In the late 1980s, the main contributor to rising health care costs was the increase in physician costs. This increase stemmed in part from an increase in the use of outpatient diagnostic and treatment facilities, some of them owned by physicians.

Studies suggest that physicians order more tests when they own a share in diagnostic and treatment facilities. This result may be a consequence of the more convenient access to tests provided by such facilities. It may also be a consequence of the incentives provided under retrospective reimbursement - physicians can earn a share of the revenue from testing facilities that they own for each test that they order, even if that test might not be necessary.

Opportunities for providing diagnostic laboratory services in physician offices have been significantly curtailed by regulations stemming from the 1988 Clinical Laboratory Improvement Amendments. This legislation imposes very costly regulations on the operation of laboratories, and these regulations are likely to be particularly onerous for the patients of physicians who operate small-scale office-based laboratories.

Along with the increased sophistication of medical technology, U.S. physicians became, on average, more highly skilled during the three decades leading up to 1990. In 1965, 24 percent of U.S. physicians were general practitioners. By 1990,

only 12 percent of U.S. physicians were general practitioners. The share of specialists among American physicians is much higher than in most other countries.

The Resource-Based Relative Value System for Paying Physicians

In response to the increases in physician costs during the 1980s, in 1992 the Medicare program began to implement a new fee system for physicians. The existing fee-for-service payment system reimbursed physicians according to a fee schedule that reflected the usual, customary fees charged by similar physicians. This payment system had the potential to lead to cost spirals. If one physician raised costs, the average fee charged by physicians would rise, and this increase could be included in the next fee schedule.

The fee system that replaced the "usual, customary" schedule is called the Resource-Based Relative Value Scale (RBRVS). In order to establish fees, a government board determines the time and complexity of the physician effort needed to provide a service and sets fees that reflect these calculations. The current scale determined by the government greatly increases the reimbursement to physicians who perform evaluative and management functions and reduces the reimbursement to surgery.

While the RBRVS is a response to an important problem in physician payment, the method used to determine the new fee schedule is economically questionable. Economists expect fees to reflect the time and effort needed to provide a service, but they

also expect fees to reflect the demand for the service and the desire of physicians to perform the service. Unless a fee schedule takes into account these fundamental economic forces, it is likely to lead to shortages and surpluses in particular specialties. For example, if a new technology arises that can be used to treat a condition, physicians who can use that technology will find their skills highly valued, even if the use of that technology requires relatively little effort. Unless the fee schedule accommodates this change in demand, there will be no incentive for more physicians to learn to use this technology.

Box 4-: Malpractice Costs

One component of the increase in U.S. health care costs has been the expansion of medical malpractice litigation. Malpractice litigation raises the cost of health care for two reasons. First, payouts to malpractice claimants and costs incurred in litigation directly affect the cost of medical care. Between 1982 and 1989, professional liability premiums, the principal source of payment for malpractice claims, grew at 15.1 percent annually, the fastest growing component of medical practice cost growth. Second, malpractice has a more insidious effect on health care costs. The threat of malpractice litigation encourages physicians to perform tests that may not be cost-effective for a particular patient, simply to protect themselves from the risk of a malpractice suit. The costs of these "defensive" medical practices have been estimated at over 20 billion dollars per year, or almost 18 percent of total physician expenditures.

Although insurers and physicians spend large sums in litigating malpractice suits, relatively little of this money makes its way to those injured. A recent study of malpractice cases in New York found that sixteen times as many patients suffered an injury from negligence as received compensation from the tort liability system. In 1984, only about 60 percent of the money expended on malpractice litigation was actually paid to injured plaintiffs.

Box 4-: Administrative Costs

An often criticized aspect of the U.S. health care system is the relatively high cost of administering the system relative to single-payer systems operating in many other countries. In other countries with multipayer systems, such as Germany, the share of administrative costs in total health expenditures is comparable to that in the United States.

Private insurance companies incur costs to market their products and to review and process claims. They also expend resources to screen and establish the health status of potential enrollees. The need to bill individual patients or insurance companies raises costs for physicians and hospitals. Overall, the administrative costs of operating the U.S. health care system have been estimated at about 40 billion dollars annually.

Although these costs are large, they should not be viewed in isolation. Private insurance companies compete, in part, on the price of the services that they offer. An insurance company, like any other firm, will only raise its administrative costs if it believes that these costs will be more than offset by savings in other portions of its business. In health insurance, much of the increase in administrative costs has come from the expansion of programs that monitor service utilization. Overall, health insurance that offers these features is cheaper than insurance that does not, despite the administrative costs associated with these oversight programs.

Recent studies that compare the total costs of health care under systems that eliminate the functions of the U.S. private insurance industry support this conjecture. They find that most of the reductions in administrative costs from moving to such a system would come from the elimination of features of the current system that reduce overall costs (such as patient payments and insurance company oversight) and that the sum of all reductions in administrative costs would be more than offset by the resulting increases in service utilization.

The Role of Competition in the Health Care Market

During the 1980s, attempts to control costs in the health care market focused on increasing the amount of competition.

Competition can lower costs if physicians and hospitals compete to attract consumers by lowering the prices they charge for their services. Under retrospective reimbursement, with limited review of service utilization, physicians and hospitals had little reason to reduce the prices they charged. Hospitals and physicians competed to attract patients by improving the quality of the services that they offered. Because of this quality competition, under retrospective reimbursement more competition in a market drove costs up.

Prospective reimbursement provides a better environment for competition to lead to reduced prices. Coordinated care programs compete to offer consumers less expensive health insurance coverage. Hospitals reimbursed under the DRG system have incentives to manage the utilization of services by their patients. Cost reductions have also been achieved in public and private plans that contract with providers to provide care at negotiated rates. Competition among insurers has led to the development of these innovative payment methods. In turn, these payment methods have provided an effective vehicle for competition among providers to lower health care costs.

PROJECTIONS OF FUTURE COST INCREASES

Many analysts expect that without substantial reform of the health care market health care expenditures will continue rising into the next century. Recent forecasts have suggested that health care may consume as much as 16 percent of U.S. GNP by the

year 2000 and as much as 26 percent of GNP by 2030.

In part, these projected increases in expenditures are a consequence of the aging of the population. The fraction of the U.S. population that will be over 65 will be increasing through 2030 and, as discussed below, health care spending increases rapidly with age. However, population aging is expected to have little impact on health care costs through the turn of the century. Population aging alone would cause health care costs to increase only to about 16 percent of GNP by 2030.

<u>Most of the projected increase in health care costs is due to an expected continuation of the historic trend of ever-increasing health care prices and intensity of service provision. Most projections of health care expenditures are based on mechanical extrapolations of such trends.</u> For this reason, these projections do not incorporate the effects of program changes. They also do not account for individual and institutional responses to the rising health care premiums and out-of-pocket costs that would accompany continued increases in health care prices and intensity. Such changes in behavior, which cannot be captured by the modeling techniques currently in use, could have profound effects on the cost of health care.

<u>The Role of Demographics</u>

Chart 4-6 describes the pattern of health care spending with age. As this chart suggests, health care spending is much higher among the elderly than among the non-elderly. Those over 65

Chart 4-6 **Per Capita Personal Health Care Expenditure, by Age, 1987**

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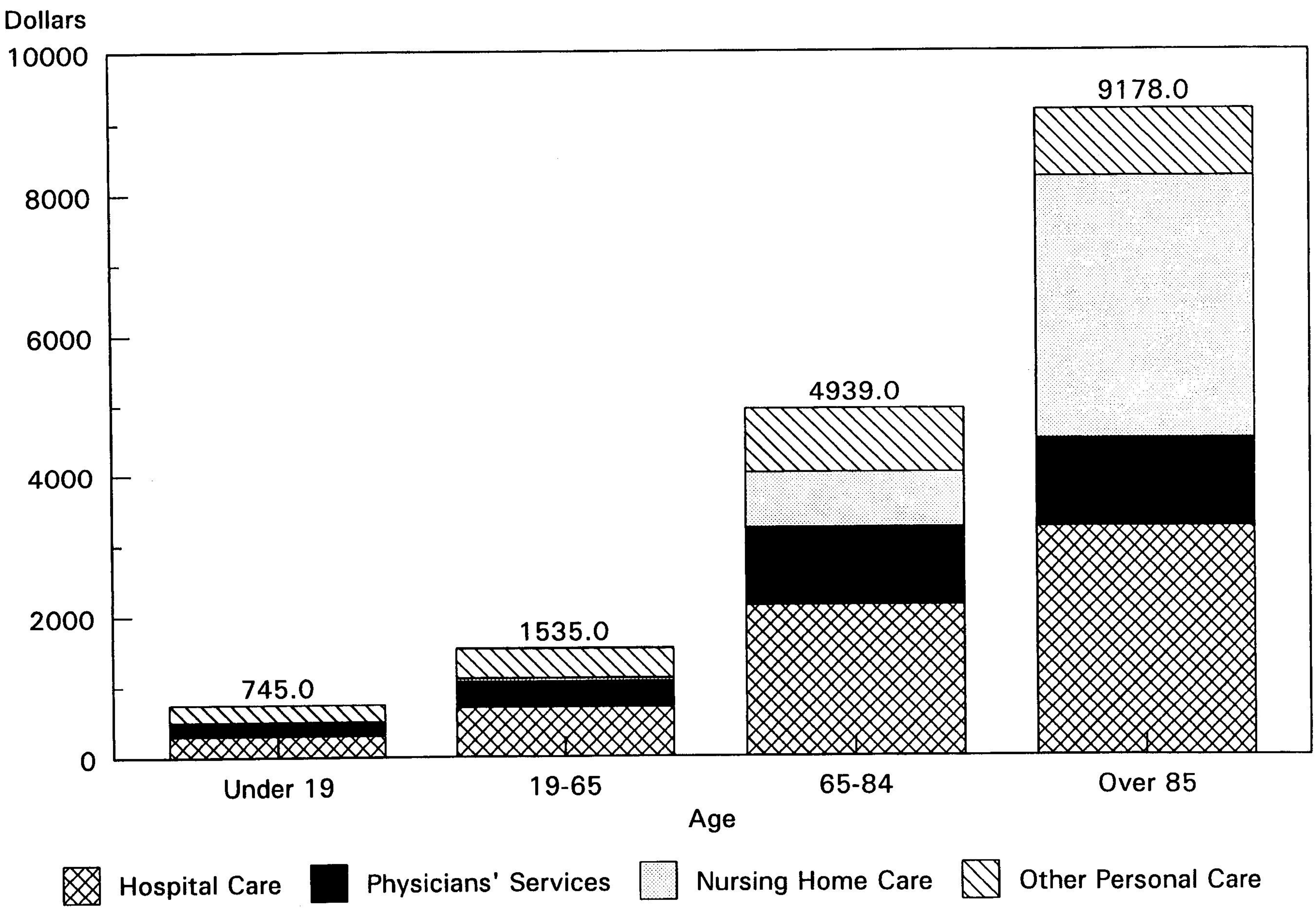

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Note:

Source: Health Care Financing Administration.

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consume about 3 1/2 times as much health care as those 19-65. Those over 85, consume almost 2 1/2 times as much health care as those between 65 and 69.

Almost all of the difference between health spending for medical and hospital care among those over 65 and health spending among those under 65 is due to the higher probability of death at older ages. Health care spending is typically very high in the last year of life. For example, 28 percent of Medicare expenditures in 1978 were spent on the 6 percent of Medicare beneficiaries over age 67 who were in their last year of life in that year. While most Medicare beneficiaries consume more than average levels of medical resources in the last year of their life, very large expenditures in the last year of life are concentrated among a small minority of beneficiaries with very costly conditions.

It is important to note when looking at health care expenditures in the last year of life that these computations are made after a death has occurred. Physicians are not able to predict with great accuracy which patients are in their last year of life. Studies show that high costs are most often incurred in cases where physicians predict that a patient will die, but the patient recovers; and in cases where physicians predict that a patient will live, but patient dies. These studies suggest that only a very small fraction of U.S. health care expenditures are spent on patients who physicians know will almost certainly not benefit from treatment.

An important source of cost differences between those over 65 and those under 65, and between those 65-84 and those over 85 is the use of nursing home care. Expenditures on nursing home care are more than 23 times larger among those over 65 than among those 19-65, and more than 22 times higher among those over 85 than among those 65-84. A substantial proportion (about 45 percent) of nursing home care provided to the aged is paid for by Federal and State governments through the Medicaid program. However, most of the remainder of the cost is paid for out-of-pocket. Most analysts expect that nursing home expenditures will grow more slowly than would be predicted on the basis of age alone because people (who pay directly for much of this care) and State governments (who both pay for care and license nursing homes) have strong incentives to limit spending.

SUMMARY

- Sources of cost growth in the U.S. health care system have varied over time. In the 1980s, increases in labor costs and in technology costs have led to cost increases.
- Changes in administrative costs have not been an important contributor to overall cost growth.
- Litigation over medical malpractice raises costs directly and by encouraging the practice of cost-increasing defensive medicine.
- Extrapolations of current health care expenditures suggest that they will consume an increasing proportion of U.S. GNP

through 2030. Some of this increase is due to the aging of the U.S. population.

THE UNINSURED AND UNDERINSURED

A critical problem in the U.S. health care sector has been the increasing number of Americans who lack health insurance. It is estimated that over 33 million Americans do not have health insurance. Because so many Americans receive health insurance through their employers, the fraction of Americans without health insurance tends to fluctuate with the business cycle. There has, however, also been a long-term increase in the number of uninsured.

Prior to World War II, fewer than 10 percent of all Americans were insured for their health care expenses. The fraction insured increased because of the expansion of employer-provided insurance and then, during the 1960s because of the expansion of public health insurance programs. But since the late 1970s, the fraction of Americans without health insurance has been increasing.

WHO ARE THE UNINSURED?

The uninsured can be characterized along a number of dimensions. Because Medicaid covers poor families with dependent children, many of the very poor are insured. However, the probability of being uninsured is highest among those with incomes below the poverty line. <u>The likelihood of being insured</u>

rises as incomes rise.

Few of the elderly are completely uninsured because Medicare provides health insurance coverage for the aged population. However, because Medicare coverage incorporates coverage maximums and patient payments, over 20 percent of the elderly are still classified as "underinsured", or at significant financial risk if faced with a catastrophic medical condition.

The probability of being uninsured is greatest among those in the 18-35 age group. These young adults, most of whom are in good health, are likely to have been previously covered by their parents' health insurance. As new entrants into the labor market, they may not have obtained jobs that offer health insurance. Young adults who work are more likely than other workers not to accept health insurance coverage even when it is offered by their employer. Young adults who lose their jobs are the least likely to pay to retain their health insurance. Finally, young adults may not yet have dependent children who would make them eligible for Medicaid.

Gaps in Employer-Provided Health Insurance Coverage

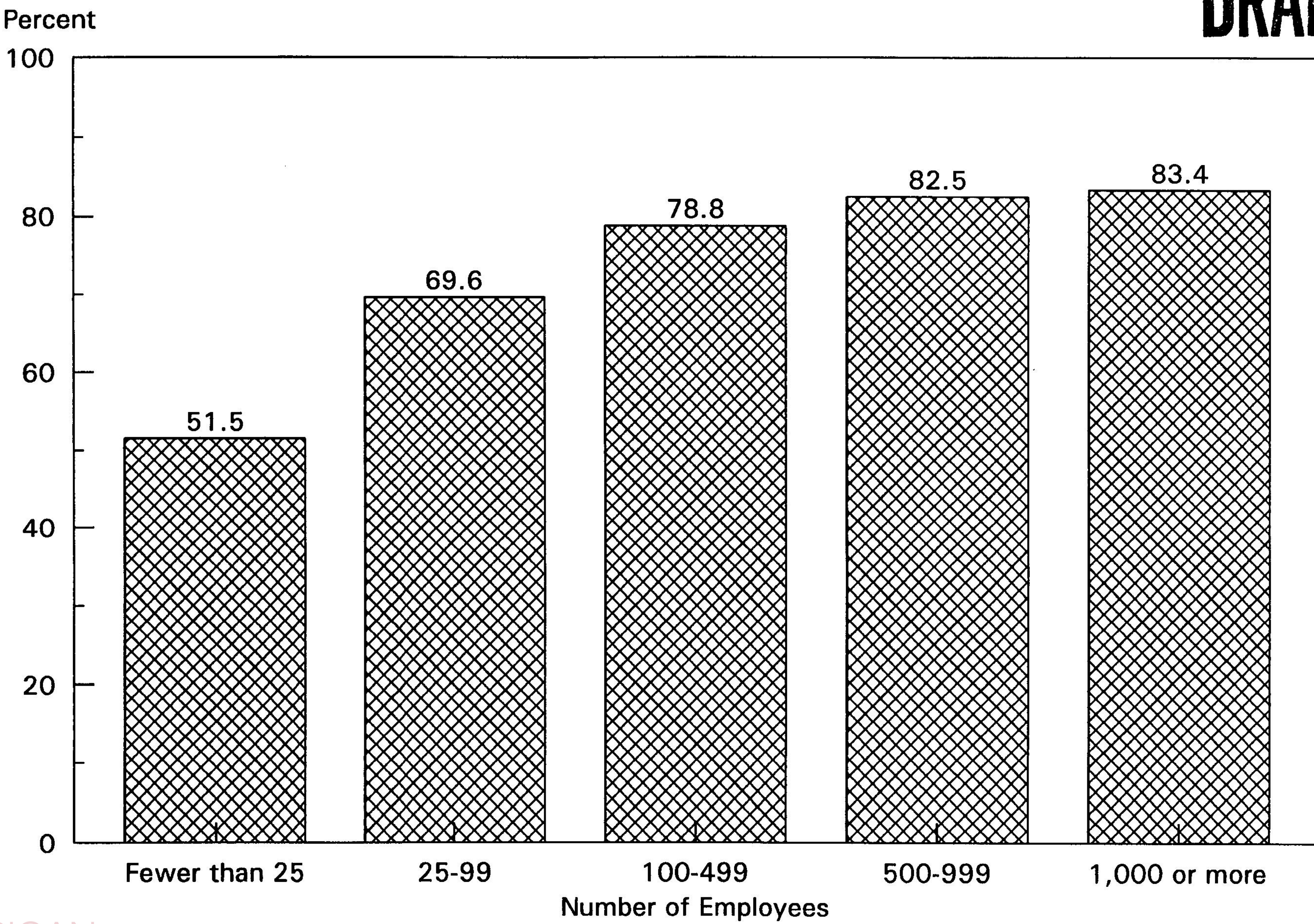
Although not having a job greatly increases the probability that an individual is not insured, the majority of uninsured Americans are workers or dependents of workers. Workers may lack health insurance because their firm does not offer it to any of its employees, because they do not work enough hours to qualify for health insurance, or because they have been offered insurance

and have chosen not to take it. While almost all large firms in the United States offer health insurance to their workers, small firms are far less likely to provide such coverage.

Chart 4-7 provides a breakdown by size of firm of the percent of employees with employer provided health insurance in 1990. Small firms are less likely to provide health insurance to their employees for three main reasons. First, the administrative costs of health insurance per employee rise rapidly as the size of a firm declines. Second, small firms are less able to self-insure their health insurance coverage. Because small firms purchase commercial insurance, which is State-regulated, they must incur costs associated with State-mandated benefits (for example, coverage for chiropractic services) and pay State insurance premium taxes. These mandates can be quite costly and have been shown to affect significantly the probability that a small employer will offer insurance. A Federal law, the Employee Retirement Income Security Act (ERISA), exempts self-insured plans (those that do not contract with a commercial insurance company but rather pay all expenses from their own funds) from State-mandated benefits. Third, risk spreading is more difficult in smaller firms where, if a single employee becomes seriously ill, the cost of health insurance for the entire small group will increase much more than for a large group.

This last observation is somewhat puzzling. The purpose of commercial insurance should be to spread risks so that premiums

Chart 4-7 **Percent of Employees with Employer-Provided Health Insurance, by Firm Size, 1990**



Note: Percentages include only persons aged 18-64.
Source: Employee Benefit Research Institute.

would not have to increase in small groups where an employee becomes ill. One way that this better risk-spreading could happen would be for small firms to purchase health insurance policies that remained in force for five or ten years, rather than the one year contracts that are now customary. However, high employee turnover rates and high business failure rates in small firms may discourage firms from purchasing such contracts. Continuing changes in treatment technologies may make it too risky for insurance companies to offer such longer-term contracts.

Most firms that offer health insurance provide insurance to their full-time employees. However, firms are considerably less likely to provide health insurance to their part-time employees. Health insurance is a "lump sum" benefit. That is, it costs a firm the same amount to provide health insurance to a part-time employee as to a full-time employee. Thus, health insurance forms a much higher share of total compensation for part-time employees than for full-time employees.

Perhaps surprisingly, the uninsured have, on average, the same health status as do insured people with similar incomes. In part this is because the uninsured are, on average, younger than the insured. In addition, the uninsured may have a low propensity to use medical services. When currently uninsured people do obtain insurance, they use, on average, fewer services than do those who are continually insured. However, the population of uninsured Americans also contains a subgroup that

is much sicker than average. This group consists of people with serious chronic health conditions. Insurance companies either entirely refuse to insure the chronically ill or only offer them insurance at very high rates.

Most people who are uninsured are uninsured for only short periods of time. Fifty percent of the uninsured are uninsured for 4 months or less. However, some 15 percent of the uninsured spend more than 24 months without health insurance.

USE OF HEALTH CARE SERVICES BY THE UNINSURED

Those who lack health insurance do not necessarily forego all health care. They may receive care that they pay for directly. Alternatively, they may receive free health care, which is provided primarily through hospitals. In 1988, U.S. hospitals provided over 10 billion dollars worth of free (or "uncompensated") care. However, people without health insurance do use less health care than do those of similar health status who have health insurance. People without health insurance are far more likely to report that for financial reasons they did not go to a doctor when they were sick. Those who do seek care are more likely to receive care in inappropriate and costly settings, such as emergency rooms. The uninsured are likely to be sicker when they are admitted to a hospital; they are also likely to be discharged from the hospital earlier than their insured counterparts.

Out-of-pocket health expenditures among the uninsured are

much higher than among the insured. The difference in out-of-pocket expenses for these two groups, however, is far less than the cost of purchasing an average health insurance policy. For those in this group who are willing to rely on emergency room care or to spend all their savings in case of a medical emergency, not purchasing health insurance could be the result of a rational calculation.

Other Problems of Insurance Coverage

Health insurance is also a concern for two other groups of Americans. One group consists of those who are underinsured, that is whose insurance leaves them susceptible to large out-of-pocket payments. Some 20 million Americans under the age of 65 fall into this category. Furthermore, over 20 percent of elderly Americans are also considered underinsured, because they have not purchased supplementary Medigap policies that cover Medicare copayments and do not qualify for Medicaid, and thus, are at risk of substantial financial burdens should they become seriously ill.

A second group are those whose health insurance ties them to a specific employer. Most private health insurance contracts contain "pre-existing condition" clauses that limit coverage for conditions that existed prior to the time that the policyholder joined the health insurance plan. People with chronic conditions may be forced to remain at their current employer because the health insurance coverage at a new employer would not cover their

preexisting health condition. Even those without chronic conditions may avoid changing jobs because they prefer to retain their current health insurance policy.

Recent Changes in the Number of Uninsured

Much of the recent increase in the number of uninsured can be attributed to the economic recession. A substantial fraction of the uninsured are unemployed. Although an existing program, named COBRA (for the Comprehensive Omnibus Budget Reconciliation Act that contained the provision) allows those who leave jobs to maintain coverage through their employer's health care plan by paying the full premium cost, few unemployed workers have taken advantage of the program.

Structural changes in the American labor market have also affected the insurance coverage rate. Workers are most likely to be covered by health insurance if they are unionized, employed in the manufacturing sector, or if they work full-time. However, these categories of employment are constant or declining. Employment in manufacturing fell from 22 percent to 18 percent of total employment during the 1980s. The fraction of private sector workers represented by a union fell from 19 to 13 percent between 1983 and 1991. The share of workers who work full-time has fallen very slightly since 1980.

These changes in the composition of the labor force, however, explain only a small portion of the long-term decline in health insurance coverage. A substantial portion of the decline

in health insurance coverage can be attributed to the rising cost of health care. As the purchase of health insurance becomes more costly, more people may find it makes sense for them to forego the purchase of health insurance and rely instead on emergency care.

Employment and Insurance Coverage

Employers must either pass along increases in the cost of employee health insurance coverage to their customers by charging higher prices for their products or pass them along to employees by lowering their wages. In competitive industries, employers are constrained in their ability to pass along higher employee benefit costs to their customers as higher prices. They must, therefore, raise wages less than they otherwise would in order to continue to offer health insurance benefits.

Between 1973 and 1989, employers' contributions to health insurance absorbed more than half of workers' real gains in compensation. Much of the earnings growth in the 1980s took the form of higher health care premiums.

Due to the tax treatment of employer-paid health insurance benefits, it costs employees less if employers make increased premium payments, and reduce wages rather than requiring employees to pay more out-of-pocket. Although health care costs have been rising rapidly, spending on out-of-pocket payments and insurance premiums as a share of after-tax income remained virtually constant, at about 5 percent, between 1965 and 1989,

for those under age 65.

For low-wage employers, the tradeoff is more complex. These employers cannot lower wages if they choose to offer health insurance, because the wages they pay would then fall below the legal minimum wage. For these employers, offering health insurance would require scaling back employment. Studies suggest that in 1988 there were almost 6 million American workers without health insurance coverage whose wages were less than the sum of the minimum wage and the prorated hourly cost of health insurance coverage. These workers are unlikely to be provided health insurance by their employers because their employers cannot recover the cost of their health insurance coverage from their wages without breaking minimum wage laws. Continuing increases in the cost of health insurance may make it impossible for some low-wage employers to offer this benefit.

SUMMARY

- The number of uninsured has increased recently. Part of this increase is due to the recession while part is a consequence of a longer-term decline in private insurance coverage.
- The uninsured are poorer and younger, on average, than the insured.
- Health care spending paid directly by patients consumes roughly the same fraction of personal income today as in 1965.

- The uninsured do receive some health care; however they receive less care and this care is more likely to take place in emergency rooms.

ECONOMIC THEORY OF THE HEALTH CARE MARKET

The observations of rapidly increasing costs and declining insurance coverage in the health care market are predictable outcomes given the characteristics of the health care market. Economic theory would predict that any market with the features of the health care market would be likely to manifest this combination of failures.

ECONOMIC PROBLEMS IN THE HEALTH INSURANCE MARKET

Most people have no interest in purchasing health care itself. They purchase health care services only in order to maintain their health. But their need for health care services depends, in part, on unpredictable events. People can respond to the possibility of such unpredictable events in three ways. They can self-insure (save money), in case of such an event. They can seek to avoid the occurrence of an event by investing in preventive health care. Finally, they can purchase market insurance.

Moral Hazard and Health Insurance

Those who purchase insurance of any kind pay a premium ahead of time that allows them to pay less than the full cost of an

insured event if and when such an event occurs. That means that the incremental cost to an insured individual associated with an insured event occurring is lower than is the cost to an uninsured individual. An individual who purchases hospital insurance will pay a premium up front. But if that individual becomes ill, the price he pays for using hospital services will be less than the price he would have paid had the insurance not been purchased. Furthermore, the cost to the patient of using hospital services will be less than the full cost of those services.

Economic theory, supported by studies of behavior, suggests that when the price of a commodity or service falls, people will usually purchase more of it. When such a decline in the price of a good or service occurs through the purchase of insurance, the corresponding normal economic behavior is called "moral hazard." In most insurance markets, moral hazard is said to occur whenever people take less care to avoid an adverse event because they are insured. Although dictionaries define the term as relating to insurance company "uncertainty about the honesty of the insured," economists do not usually view moral hazard as evidence of dishonesty. Instead, economists use the term to describe behavior that might be viewed as carelessness induced by the existence of insurance. For example, people insured against car theft display moral hazard when they take less care to lock their car doors than they would if they didn't have the insurance.

In the case of health care markets, this problem is complicated by the nature of the insurance provided. In most

other insurance markets, insurance is intended to replace a particular item (a car or a house). The insurance company charges a premium that reflects the cost of replacing that item. But no insurance company can insure health itself. No health insurer can promise that purchase of a policy will cause the insurer to replace an individual's health the way that an auto insurer can promise that a policy will provide a policyholder with the means to replace a 1989 Chevrolet. Health insurers instead promise that they will provide the means to pay for reasonable and customary treatments for any medical condition that may occur. Health insurance contracts are much more open-ended than other forms of insurance contracts.

Because of the open-ended nature of health insurance contracts, the insured may also consume more medical services to treat a particular condition when such a condition occurs. Since they no longer bear the full cost of additional services, those with insurance may select expensive treatments for their conditions, even when less expensive treatments would be equally effective. This overconsumption of medical care services is also a consequence of moral hazard.

The purchase of health insurance reduces the incentive to avoid an insured event, for example by locking car doors, or getting a flu shot. It also reduces incentives to economize in the use of health care services should an adverse event occur.

In response to the increased use of health care services that results from moral hazard, insurance companies will raise

the premiums for insurance to cover the cost of the additional services that they expect policyholders to purchase even though policyholders would prefer to pay lower premiums rather than consume these additional services. To see this, consider a patient who has a headache. The physician can confirm the diagnosis of a stress headache by talking to the patient and learning the patient's history or by using a magnetic resonance scan. Taking the patient's history is much less costly than the scan, but the patient is fully insured and will not have to pay the bill in either case. Many patients would prefer to buy a policy that would require that a history be taken in this sort of situation, rather than paying a higher premium for a health insurance policy that would cover the cost of a magnetic resonance scan. The problem is that without monitoring the situation directly the insurer has no way of knowing whether the headache is one that calls for a magnetic resonance scan or not, and the insurance purchaser has no way of credibly promising the insurer that he will choose having a history taken rather than scans if a headache of this type occurs and both are offered. So the insurer will have to charge a higher premium to cover the cost of the scan that he expects the patient to choose, and the patient might just as well have the scan. As in this situation, when moral hazard exists, policyholders will generally consume services that they value at less than the full cost of those services. Furthermore, these policyholders will pay premiums that include the cost of these additional services.

Economic theory predicts the existence of moral hazard in health insurance markets. Studies suggest that moral hazard is indeed quite important in raising health care costs. A study by the RAND Institute during the 1970s gave randomly-selected families health insurance policies that provided them with full insurance for all health care services. The study gave other families a cash payment of $1000 together with health insurance policies that made them liable for their first $1000 in health care expenses. Although both families were equally well indemnified, the use of medical services among those who were fully insured was found to be almost 30 percent higher than among those who faced the full cost of their first $1000 in medical expenses. Furthermore, according to most measures of health status, families in both groups were equally healthy at the end of the 3-5-year experiment.

Insurers can respond to the problem of moral hazard in two ways. One, which has traditionally been used in health insurance is to require those who are insured to bear a part of the cost of their services through the use of deductibles and patient payments. An alternative way to deal with moral hazard is for the insurer company to monitor whether a policyholder is taking appropriate care to prevent an insured event and to limit service use if an insured event occurs. In health care, this means ensuring that a policyholder uses preventive services and reviewing the policyholder's service utilization. By monitoring these services the insurer can be certain that a policyholder

uses only those services that are valued at their full cost. This is the approach traditionally taken by coordinated care organizations. These organizations typically have low co-payment and deductible rates but provide free preventive care services and closely monitor the utilization of health care services among those who are ill. Conventional insurers have also begun to adopt these monitoring practices (through second opinion for surgery requirements, for example).

The theory of moral hazard, in combination with the structure of the U.S. health care system, helps explain why health care costs have risen so sharply. The tax subsidy for health insurance has encouraged employers to provide employees with coverage that includes very low co-payment and deductible rates. As a consequence, out-of-pocket payments for health care have been falling over time. Because Medicaid serves a low income population, it does not require out-of-pocket payments. Substantial out-of-pocket payments are required in the Medicare program, but most beneficiaries own medigap policies that eliminate most of the cost-sharing provisions of Medicare. As cost-sharing falls, the incentive for consumers to moderate their purchase of health care also declines.

At the same time, the open-ended nature of health insurance contracts means that any new technologies that are developed and that are viewed as non-experimental will be covered by health insurers. This combination of incentives may lead to a higher rate of innovation and of introduction of new technologies into

the health care market than consumers would pay for in the absence of insurance.

Adverse Selection in Health Insurance Markets

People usually know more about own health and their need for health care services than do insurance companies, and this asymmetry of information has important implications for the health insurance market. An insurer charges a premium based on the average need for health care services. For those who anticipate that their need for health care services will be greater than average, health insurance is a bargain. But those who anticipate that their need for health care services is likely to be below average may find buying health insurance at the average price to be a poor investment. They may choose to self-insure or to purchase a health insurance policy with very high deductible and co-insurance levels. This process is known as "adverse selection".

Adverse selection will occur whenever policyholders have more information than insurers and have choices in the health insurance market. If people can choose whether or not to participate in the health insurance market or can choose which plan to purchase, they will use their private information to their advantage.

If those at low risk drop out of the health insurance market, the average rate for the higher-risk people who remain will rise. In theory, if this adverse selection behavior

continues, the market for insurance may disappear altogether. Alternatively, people may sort themselves into high and low-risk groups and purchase different kinds of insurance. If this occurs, those at high risk will purchase comprehensive health insurance plans and face premiums that reflect the full costs associated with their true health status. Low-risk people will purchase insurance that is less comprehensive in order to distinguish themselves from those at high risk. These low-risk people will then pay low premiums that reflect both the type of plan they purchase and their health status.

Economic theory predicts that adverse selection will lead to lower rates of health care coverage among those at low risk of health expenses and high premiums for those at high risk. Studies support this finding. Among firms that offer multiple health insurance plans, premiums for plans that offer very complete coverage are much higher than premiums for plans that include high deductibles and require beneficiaries to a substantial share of their costs. The difference in premiums cannot be explained by the additional services offered or by moral hazard in the richer plans. Rather, the evidence suggests that those who choose the richer plans are in poorer health than those who choose the lean plans.

Adverse selection can only occur if insurers are unaware of or cannot respond to the health status of policyholders. If insurers can observe the risk characteristics of those they insure, they can adjust premiums accordingly. People at high

risk would be charged high premiums that reflected all the costs that they would be expected to incur and people at low risk would be charged low premiums that reflected their true costs. High- and low-risk people would have the option of purchasing equally comprehensive health insurance coverage. There would be no incentive for low-risk people to go without insurance.

Currently, insurers cannot fully observe the health characteristics of those they insure. As a consequence, those who choose to purchase health insurance are charged premiums that reflect the average health characteristics of health insurance purchasers. For example, young people who know that their health is better than average may not find it worthwhile to purchase health insurance at these rates or to take jobs that offer low wages but include health insurance benefits. Thus, it is not surprising that a large fraction of the currently uninsured are young and healthier than average.

Adverse selection can occur because employers cannot observe health characteristics or because they are not permitted to respond to differences in health characteristics that they do observe. <u>If insurers are required to charge all purchasers of health insurance in a community the same premiums, for example, a practice known as "community rating," they are prevented from responding to even readily observable health characteristics. Premiums will then reflect average health characteristics and people who know that they are at low risk will leave the market altogether.</u>

Ironically, improvements in diagnostic and management technology provide an additional reason for health insurance coverage to become less readily available. As physicians are better able to diagnose chronic health conditions and insurers are better able to track such conditions, they can charge people insurance premiums closer to their true cost of health care. For those with poor health conditions, premiums based on true cost may be extremely high premiums.

LACK OF INFORMATION IN HEALTH CARE MARKETS

The existence of moral hazard and adverse selection means that insurance markets function poorly when policyholders have more information than do insurers. Similar information asymmetries exist in many other parts of the health care market. In particular, physicians have much more information about how to treat a particular illness than do their patients. Furthermore, patients not only find it difficult to evaluate their treatment, they also cannot easily tell whether the outcome that they experience is a consequence of the physician's behavior or of their underlying condition. In this respect, health care differs from other service industries (such as restaurants and hairdressers) where customers may not be able to perform the service but can easily evaluate the outcome. Health care is not, however, the only industry where consumers do not have complete information about provider behavior. The car repair market, for example, shares this characteristic with the medical market. Few

consumers can evaluate their mechanic's abilities, ascertain whether their mechanic's failure to repair their automobile was due to the mechanic's incompetence or to the complete disintegration of their car, or discern whether the repairs suggested by the mechanic are superfluous and exorbitantly priced.

Asymmetries of information about processes and outcomes in the health care market make it difficult for people to make decisions about the purchase of health care services. A physician who charges a low price may do so either because the services being provided are provided in the most cost-saving way or because they are of inferior quality. People have traditionally tried to overcome these asymmetries by evaluating a primary care physician (through recommendations from friends, by examining the physician's credentials, or evaluating the physician's bedside manner) and then accepting the primary care physician's advice on further treatment. However, these ad hoc techniques may not be very useful in assessing physician quality.

Studies show that there is enormous variation in the practice of U.S. physicians treating very similar patients. For example, rates of use of certain discretionary procedures, such as tonsillectomies, can vary by a factor of 10 across neighboring counties with very similar populations. In many cases, the use of such procedures deviates substantially from that recommended in guidelines prepared by experts. Rates of mortality for very similar patients differ considerably across hospitals and across

physicians.

Without good measures of quality, it is difficult for health care plans to compete on the price of services they offer. Why then does this information not exist in the market? A possible reason is that it would not make economic sense for any single health care provider or insurer to expend resources trying to develop a process to measure and advertise the quality of care it provided. Such a system would be very costly to develop, and once developed it would be very easy for other health care plans to simply copy the system at very little cost.

Despite these impediments, there have been some recent attempts by insurers and employers to develop systems for measuring the quality of health care provided. A major initiative launched by the Federal government has been the annual publication of mortality rates adjusted for the severity of patient illness for Medicare patients in every hospital in the United States. A variety of private sector initiatives have addressed the lack of information in health care markets, including the Washington Consumers' Checkbook, which provides an annual guide to federal employee health plans; the Pennsylvania Health Care Cost Containment Council, which publishes information about hospital charges and mortality rates; and employers in Cleveland who sponsor the Cleveland Health Quality Choice Project, which is developing measures to compare the quality of care in Cleveland-area hospitals.

CONCERNS OVER THE DISTRIBUTION OF HEALTH CARE RESOURCES

Asymmetries of information, whether between insurers and policyholders or between providers and patients, can cause the health care market to operate inefficiently, failing to provide the best possible outcomes for the available resources. Some people who would be willing to pay the full cost of their health insurance will not be able to purchase insurance. Some patients who would be willing to pay for better care cannot find it.

But even if these asymmetries could be eliminated, and the health care market operated efficiently, health care, like all other goods and services, would still be costly. Faced with costly health care, some Americans, especially those who are poor or who have chronic health conditions, would not pay to purchase health care.

This unequal distribution of health care resources is an important policy concern. Most Americans believe that everyone should be entitled to at least basic health care, regardless of their income or health status. This belief distinguishes the health care sector from most other parts of the U.S. economy and explains why charitable organizations have always played an important role in the delivery of health care. Public and voluntary hospitals continue to provide, to some extent, a health care safety net. However, the ad hoc functioning of this safety net causes three further problems in the health insurance market.

First, because this safety net operates principally through hospitals, most of the uninsured receive care only when their

conditions are quite serious. In many cases, this care could be provided more effectively earlier in the course of their illness. Furthermore, providing emergency care through hospitals is likely to be much more costly than providing preventive care outside hospital.

Second, although most Americans agree that everyone should receive basic health care, all Americans do not share equally in the burden of this care. Instead, insurers expend resources to avoid paying additional charges to cover the uninsured. For example, insurers may spend resources to make sure that hospitals do not charge them higher fees in order to cover the cost of the uninsured. These expenditures, devoted only to cost-shifting, are socially wasteful. This element of administrative cost increases the total cost of health care in the United States.

Finally, the existence of this safety net may discourage some people from purchasing health insurance. Especially for those with serious health conditions for whom market insurance would be very costly, remaining uninsured may be better than purchasing insurance.

Programs that provide support for the purchase of health care to those with low incomes can have some undesirable effects. As family incomes rise, support under income-tested health programs would be phased-out. As with similar provisions in other government programs (such as AFDC), this phase-out would mean that families with incomes in the phase-out range would face a very high marginal tax rate. Small increases in their income

would be accompanied by relatively large reductions in the value of the health care support they receive. Such phase-out provisions may discourage people from trying to increase their incomes.

While most Americans would agree that providing better health care to those in need is a critical goal, better health care alone may not improve the health of the poor. Evidence from both the U.S. and other countries casts doubt on the impact of better access to health insurance on health. U.S. studies suggest that the Medicaid program, which provides care to the poor, did not narrow the gap in mortality and illness between the poor and those of higher income. In Canada, the introduction of universal health insurance greatly improved access to care among those with low incomes. Currently, poor Canadians consume more health care services than do the non-poor. However, there has been little improvement in the relative health status of the poor. For certain conditions, the health gap in Canada has narrowed, but for other, equally serious conditions, the gap in health has widened. Finally, studies from the United Kingdom that relate socioeconomic status to health also find an increase in the gap in mortality between those of high socioeconomic status and those of low socioeconomic status since the introduction of the National Health Service.

SUMMARY

- Health insurance reduces the price of incremental units of health care services for policyholders. Thus it can lead to moral hazard, which is the consumption of health care services that are not valued at their full cost.
- When policyholders have more information about their own health status than insurers do (or than insurers are permitted to use), adverse selection, or self-sorting on health risk, may occur. In the extreme case, this behavior can lead to the destruction of the entire health insurance market.
- A lack of information may lead patients to spend money on services that they (might not otherwise choose). New initiatives would improve the provision of information to purchasers of health insurance coverage.
- The existing safety net for the uninsured has holes in it. The uninsured receive insufficient and often inappropriate forms of care and have incomplete incentives to purchase insurance.

PROPOSALS FOR REFORM OF THE HEALTH CARE MARKET

The increasing costs and decreasing rate of insurance coverage in the U.S. health care market have led to a proliferation of ideas for market reform. Some 70 Bills for reform of the health care market have been introduced in the past year. While most of these plans seek to alleviate these symptoms

of ill health in the health care sector, relatively few address the underlying causes of cost increases and insurance gaps.

The sources of cost increases and insurance gaps include incentives to overuse services (moral hazard) and to use personal health information in making decisions about purchasing insurance (adverse selection), as well as the lack of information about the quality of providers. As the response to the introduction of the DRG system in hospitals has shown, changing incentives can lead to major modifications in health care provision. Because of the flexibility and responsiveness of the health care sector, health reforms that address underlying economic problems and provide sound incentives can be very effective. On the other hand, reforms that ignore the economics of health care are likely to lead to perverse and undesirable results. Table 4-3 provides a summary of the main proposals for health care reform, which are discussed below.

ADMINISTRATION PROPOSAL

The Administration's health care reform proposal is a comprehensive, market-based reform that builds on the strengths of the existing market. The plan includes components designed to both expand access to health insurance and improve the functioning of the market.

Table 4-3: Side-by-Side of Health Insurance Plans

Issue	Administration Proposal	Jackson Hole Proposal	Pay-or-Play and Rate Setting	National Health Insurance and Global Budgets
Cost Containment				
Moral Hazard	o Encourages managed care for public programs	o Promotes use of basic benefit package	--	--
Other	o Increases competition in small group market and public programs	o Increases competition in small group market	o Provider and hospital fee schedule for all payers	o Global budgets
Access				
Poor	o Provides low and middle income people with insurance certificate/ deduction	o Mandates coverage through employers o Provides subsidies to low income people who are not employed and to part-time workers	o Requires employers to offer insurance or pay into public plan	o Universal coverage
Ill Health	o Implements health risk adjusters for high risk people in individual and small group health insurance markets	o Makes basic benefits available to all on community-rated basis	o Covers employed persons in ill health	o Universal coverage

Access to Care under the Administration Proposal

As noted above, an important motivation for improving the health care system is to provide better access to health care for the poor and for those with poor health conditions. The Administration's plan provides access to health care coverage for low-income Americans through a refundable tax credit, that can take the form of a transferrable health insurance certificate for those who do not file tax returns, which can be applied to the purchase of a health insurance plan. Low- and middle-income people not covered by existing public health insurance plans would be eligible for a tax credit or deduction for the purchase of health insurance. The maximum amount of the credit would range from $1,250 for single persons to $3,750 for families of three or more.

The U.S. Treasury estimates that, when fully phased in, the health insurance tax credit/certificate and deduction would benefit about 90 million people. About 25 million of these beneficiaries would be low-income people receiving the maximum applicable credit. Another 10 million would have incomes between 100 and 150 percent of the poverty level and would receive a partial credit or deduction. Finally, 56 million middle-income people would receive a partial deduction.

States would be required to develop a basic insurance package equal to the value of the health insurance credit offered by at least two insurers, one of which would have to offer coordinated care. Low-income Americans would be able to purchase

basic insurance using their tax credits. They would no longer have to rely on the public hospital safety net. At the same time, the fixed dollar nature of the credit/deduction does not encourage overconsumption of health insurance. While the tax credit/deduction can be used toward the purchase of richer than minimum benefit plans, the full additional cost of these plans would be borne by the purchaser.

A second feature of the plan is that recipients of the tax credit/deduction would be required to participate in health risk pools employing health risk adjusters. This feature of the plan addresses the concern that those with poor health conditions should be able to purchase health care. Through the use of these pools, the additional cost of poor health will be spread among all credit-assisted purchasers of health insurance. Low- and middle- income people with poor health status would have greatly improved access to health care through the combination of tax credits/deductions and health risk pools.

Although the health risk pools would enable people with poor health conditions to purchase health care at a reasonable cost, they would not eliminate the problem of adverse selection. Under the Administration's plan, people are not required to purchase health insurance. Those who know that their health is unusually good, and who would receive only a partial credit or deduction through the credit/deduction program, might choose not to purchase health insurance and continue to rely on the existing health safety net. The only way to completely eliminate this

problem would be to require everyone to have the same type of health insurance.

The President's plan encourages States to fold their existing Medicaid programs into the individual tax credit/deduction program. Those who are Medicaid eligible would receive the full individual tax credit and could then purchase basic benefit coverage through any one of the plans offered in the State.

Expansion of health insurance coverage is further encouraged by the small group reforms proposed by the plan. The plan encourages the use of Health Insurance Networks (HINs), which would act as group purchasing agents for members (smaller employers), obtaining more favorable premiums and reducing administrative costs. One reason that small firms are less likely to offer health insurance coverage than large firms is that they are required to provide State-mandated benefits (for example, coverage for chiropractic services) and pay State premium taxes, while large firms can exempt themselves from these State regulations by self-insuring their health plans. These mandates can be quite costly and have been shown to significantly affect the probability that a small employer will offer insurance. The plan would provide explicit encouragement of HINs through extending the federal preemption of State regulation of self-insured benefit plans under the Employee Retirement Income Security Act (ERISA) to small firms purchasing health insurance through HINs.

Like credit-assisted purchasers of individual health insurance, smaller businesses would be grouped into risk pools that use health risk adjusters to spread the cost of poor health conditions across all small firms that purchase health insurance. The plan also prohibits all health insurance plans from excluding any individual or group from health insurance coverage because of a pre-existing condition, and requires insurers to renew coverage to any existing group that complies with its insurance contract. These features of the plan would reduce existing impediments to labor market mobility among those with pre-existing health conditions. They would also reduce some of the administrative costs associated with pre-insurance screening of individuals and employees in small group plans. Some of these administrative cost savings, however, would be offset by the costs of administering the Health Risk Adjuster System.

Cost Control under the Administration Plan

Other aspects of the Administration's proposal are designed to improve the functioning of the health care marketplace. The proposal includes a comprehensive liability reform plan that would limit the costs associated with the medical malpractice system. The plan would provide States with incentives to cap the amount of allowable losses for damages other than the loss of income and the cost of medical care associated with an injury. States would be encouraged to employ systems of Alternative Dispute Resolution that have been shown to increase pretrial

settlements. The Federal government would also intensify existing efforts to create guidelines and quality standards for medical care. These guidelines could be used in the legal system to determine whether care had been provided negligently. If the legal system relied on established standards to determine negligence, physicians would no longer have to practice defensive medicine. Standards could also improve the quality of care by informing physicians of the state-of-the-art in treatment for particular conditions.

The Administration's plan will increase incentives for the use of coordinated care delivery systems in Medicare and Medicaid. The use of coordinated care payment mechanisms that provide insurers with ways to monitor utilization directly, reduces the extent of moral hazard in health insurance contracts. The Administration would provide both HMO and alternative coordinated-care options to Medicare beneficiaries and would increase financial incentives for Medicare beneficiaries to join HMOs. The plan would require States either to shift all non-elderly Medicaid beneficiaries into coordinated care programs or to fold all Medicaid beneficiaries into the tax credit/deduction program.

Under the Administration's proposal, people who receive tax credits or deductions, including those who were formerly receiving Medicaid, would be able to choose their health insurer from at least two plans that would be available in every geographic area. Competition between the plans would be used to

ensure an adequate level of service. If one plan provided poor quality service, those insured could choose another plan.

The Administration's plan would address the lack of information in health care markets by requiring States to implement programs to help make information about the cost and quality of medical services available to consumers. The Federal government would assist the States by developing prototype systems to assist in data gathering and outcome comparison. Similarly, the proposal calls for the Federal government to work with the private sector in developing record keeping and billing forms that would reduce the administrative costs of health care provision.

The most important component of the Administration's proposal with respect to improving health is its emphasis on prevention. The proposal calls for substantially increased spending for Federal preventive care programs and for an expansion of primary care health services to low-income communities. It also increases funding for programs aimed at encouraging Americans to make healthier choices with respect to smoking, physical fitness, and diet.

Box 4-: Health Risk Adjusters

The health risk pools envisioned under the President's plan would incorporate a system of health risk adjusters. Health risk adjusters are a set of transfers from low-risk to high-risk people that are based on the health status of each individual. Each insured person would be assigned to a health risk category. Each health risk category would be assigned a weight that

depended on the ratio of the average expenditures for those of that age in that category to average expenditures for all people of that age. An insurance company providing coverage to an individual in a high-risk category would receive a payment equal to the weight for that category. An insurer providing coverage to an individual in a low-risk category would make a payment into the risk pool equal to the weight for that category.

Health risk payments would be age-group specific. Thus, younger people, who are on average quite healthy, would not be subsidizing older people, who are on average less healthy. That means that implementation of a health risk adjuster system would not give younger people additional incentives to leave the health insurance market. At the same time, the health risk adjuster system would leave everyone with the incentive to save money for their old age when their health can be expected to deteriorate.

This system of payments is intended to equalize the cost of insuring those who differ only with regard to health status. Because the weights for payment are based on average expenditures, they leave insurers with full incentives to control the cost of care for high-risk policyholders, limiting moral hazard.

JACKSON HOLE GROUP PROPOSAL

The Jackson Hole Group (an ad hoc collection of policymakers and academics) has proposed a set of reforms designed to establish a system of "managed competition" under the regulation of the government. The proposal focuses on reforms to improve the operation of the marketplace and emphasizes an expansion of health insurance through the workplace.

The central structure in the JHG reform is the "Accountable Health Partnership." An accountable health partnership would combine employers, insurers, and providers into a unit that would integrate the financial, managerial, clinical, and preventative aspects of health care. Each Accountable Health Partnership

would be registered with a National Health Board. The National Health Board would have three subsidiary standards boards that would establish accounting standards, determine whether services should be included in "Uniform Effective Health Benefits," and monitor the provision of insurance.

Accountable Health Partnerships would be required to provide the full array of "Uniform Effective Health Benefits," (UEHB) that were determined by the National Health Board. These benefits would be uniform and restricted to services that had been demonstrated to be effective. <u>All insurers, both private and governmental, would be required to offer the same basic benefit plan. Competition would focus on providing these benefits in a cost-saving and medically effective fashion.</u> Those who chose to consume services beyond those included in these UEHB would face the full cost of this additional health care. This aspect of the JHG proposal would limit moral hazard in the purchase of benefits beyond the plan.

In order to improve access to care, the JHG proposal would mandate all employers to cover all full-time employees. Employers would be required to make a contribution to an insurer for each of their employees. The contribution would consist of a flat amount, chosen by the employer, that is between 50 and 100 percent of the cost of the lowest-price Accountable Health Partnership in the applicable area, regardless of which insurer or plan an employee chooses. The 50 percent minimum contribution requirement has been designed to limit adverse selection. Even

healthy employees would be likely to find it in their interest to purchase health insurance if they only have to pay half the premium. The minimum UEHB requirement eliminates a form of adverse selection in which low-risk people purchase extremely minimal benefit packages that would never be chosen by those at higher risk. The 100 percent limit would be imposed to limit moral hazard. Employees would face the full cost of additional coverage if they chose a plan whose price exceeded that of the lowest-priced plan.

The JHG proposal requires that one Health Insurance Purchasing Corporation (HIPC) be established in each geographic area of each state to act as a collective purchasing agent for small employers. These HIPCs would pool risks across all small employers, although they could charge age-rated premiums. The JHG proposal suggests the enactment of legislation to encourage small groups to join HIPCs. For example, only employers who join HIPCs would be able to use the favorable tax treatment for health insurance.

Part-time employees and nonemployed persons would also participate in the HIPCs. Employees of part-time employers would be required to pay a tax to the Federal government (related to the hourly cost of health insurance coverage) that would be used to subsidize the purchase of health insurance by part-time workers. A similar tax would be placed on the incomes of the nonemployed, with proceeds used to pay the premium for the lowest-priced available plan for each of the non-employed.

States would contract with HIPCs to enroll all non-employed persons who are not insured by existing public programs.

Under this proposal, only one HIPC would be available in each area. The HIPC might contract with many Accountable Health Partnerships, and there could be competition on quality of service among these Accountable Health Partnerships. The National Health Board would be responsible for ensuring that the HIPC and each participating Accountable Health Partnership met accounting, insurance, and benefit standards.

NATIONAL HEALTH INSURANCE PROPOSALS

Proposals for national health insurance envision the replacement of the private health insurance market with a single national health insurer. This national health insurer would use taxpayer funds to pay for care that would either be free (as in Canada) or that would have a low cost-sharing level. National health insurance would provide equal access to health care for all people, regardless of income or health status.

National health insurance provides few incentives to consumers to monitor their use of care. Rather, the cost of health care is shared among all taxpayers. The potential for moral hazard is very high. The Canadian experience and the results of the RAND experiment suggest that substantial utilization increases would be likely to accompany a move toward national health insurance.

Furthermore, the lack of any incentive for consumers of care

to reduce the cost of health services provides no impetus for the development of more efficient systems for the delivery of care. Improvements in health care delivery would only be made by government dictate.

Because there are no demand side forces encouraging efficient delivery of care, the delivery of care must be constrained from the supply side. The government must take a very active role in deciding how much health care will be provided. The number of physicians in practice, the number of hospital beds, the availability of new medical technologies and of new treatments must all be determined centrally by the government.

Such government-determined supply side controls may lead to inappropriate decisions at the level of the individual provider. For example, hospitals are likely to find it easier to stay within their annual budgets if they keep their hospital beds filled with patients who have already recovered rather than admitting new, sicker patients. Physicians who are paid according to a restrictive fee schedule are likely to increase the utilization of their services to maintain their incomes. For example, physicians can recommend that their patients make an office visit to be informed of the results of standard medical tests, rather than simply conveying this information over the phone or by mail. Studies of the Canadian system suggest that very substantial amounts of patient time can be wasted through such unnecessary increases in the utilization of physician

services. Global budgets for physicians may lead them to restrict their hours and increase their vacations days, rather than inducing them to provide cost-effective care.

Government-determined allocation decisions are also likely to become politicized. Decisions about which services to cover and what payments to make may be influenced by the political clout of provider groups rather than by appropriate economic and medical considerations.

Most proposals for National Health Insurance also envision cost-savings through reductions in administrative costs. However, reductions in administrative costs are likely to be accompanied by increases in service utilization and are not likely to lead to net health care cost savings.

PLAY-OR-PAY

Play-or-pay proposals for health care reform are built around requirements that firms either provide basic health insurance to employees and their dependents ("play") or pay a payroll tax to cover enrollment in a public health care plan ("pay"). Most play-or-pay proposals would also offer sliding subsidies to those who are not attached to the workforce.

Play-or-pay proposals focus on improving access to health insurance. By requiring all employers to provide access to health insurance, play-or-pay would substantially reduce the number of uninsured Americans. While play-or-pay would improve access to health insurance for workers with low incomes or poor

health status, play-or-pay may reduce the welfare of many low-income people. Because competitive firms usually cannot pass along cost increases to their consumers, employers would have to pass along the costs of health insurance to their workers in the form of lower wages. Thus, mandating health insurance through the workplace would likely lead to lower wages among currently uninsured employees and to increased unemployment among employees who are paid wages close to the minimum wage.

An advantage of the play-or-pay reform over national health insurance is that it would retain competition in the employer-based system, while providing health insurance to those who are uninsured under the current system. However, firms who offer benefits that are similar to those offered in the public plan may also switch to the "pay" option if the cost of their health insurance premiums is greater than the payroll tax.

Play-or-pay alone does not directly address the problem of controlling health care costs. The effect of pay-or-play on costs would depend greatly on the structure of the public health insurance program, because a play-or-pay system would greatly increase participation in this program. The existing public program for the non-aged, Medicaid, includes only limited provisions to reduce moral hazard. Because Medicaid covers a population in poverty, the program does not currently incorporate patient payment requirements; managed care initiatives for Medicaid have only recently been launched. The public program in a pay-or-play system would have to include more patient payment

requirements and managed care initiatives than Medicaid currently incorporates. Otherwise, pay-or-play could lead to increased moral hazard and more overconsumption of medical resources.

Some play-or-pay proposals incorporate provisions for all-payer rate setting by the government. All-payer rate setting, which is currently in use for hospital billing in some States, means that a governmental agency sets a single schedule of health care prices that is used as the basis of payment by all insurers and payers. Increases in utilization often accompany such restrictions on prices in the health care market. In part, this relationship is an outcome of the difficulty of measuring prices and quantities in health care. Providers of health care services can easily transform changes in price into changes in the quantity of health care services provided. For example, an increase in the number of diagnostic tests provided to a patient will appear to be an increase in the per-visit price if all the tests are provided during one visit. This same increase will appear to be an increase in quantity, instead of price, if the tests are spread over multiple visits.

Problems in measuring units of health care services make the enforcement of price controls in this sector troublesome. The Canadian experience suggests that the implementation of price controls in a fee-for-service physician payment system is likely to be accompanied by large increases in utilization. Such increases in service use, if caused by fragmentation of services, may have important unseen costs to consumers in the form of time

wasted on excess appointments.

Play-or-pay would provide health insurance to those with poor health conditions who may not be able to afford insurance in the current market. However, these people are likely to be insured through the public program. Firms who hire workers with serious health conditions can avoid paying high insurance premiums by switching to the public plan. As a consequence, the cost of providing care in the public plan is likely to rise. Payroll tax rates may have to be raised to offset this increase in costs.

Box 4-: Oregon Medicaid Waiver Proposal

The State of Oregon has developed an innovative proposal that would extend Medicaid insurance coverage to all Oregonians with incomes below the federal poverty line. The plan would extend coverage to this broader group of people by restricting the treatments that would be made available to those covered. As proponents of the plan put it, services, not people, would be rationed.

In order to determine which services would be provided, the Oregon Health Services Commission undertook an extensive process of research and analysis and consultation with the public. Initially, the Commission identified 709 condition-treatment pairs (such as appendicitis-appendectomy). Next, the Commission classified each pair into one of 17 categories according to the outcomes that could be expected from the treatment, such as "Prevents death with full recovery" and ranked the pairs within each of the categories according to their impact on the quality of life. Finally, the Commission submitted the ranked list of 709 pairs to the State Legislature.

The Legislature appropriated funds to cover services 1-587 on the list. These condition-treatment pairs would be included in the basic medical plan. Those condition-treatment pairs ranked 588-709 would not be covered for those insured by Medicaid in Oregon.

Because Medicaid is funded jointly by the Federal government and the States, Oregon had to apply for a waiver from the Federal government in order to implement this plan. This waiver was denied to the current version of the Oregon plan in September, because of concerns that it violated the rights of the disabled under the Americans with Disabilities Act.

GLOBAL BUDGETS

A highly touted proposal for controlling costs in the health care system has been to implement global budgets for all health costs. Global budgets would set a fixed sum to be spent on health care in the entire U.S. economy.

It would be very difficult to implement global budgets in the highly fragmented health care sector that now exists. For example, a global budget would have to account for out-of-pocket payments made by consumers, fee-for-service payments made by conventional insurers, per capita payments made by HMOs, and the provision of uncompensated care in emergency rooms. Most global budget plans would begin through the implementation of price controls. As noted above, such controls are likely to lead to increases in observed utilization.

Global budgets might also be applied to individual hospitals. These budgets could be made independent of the number of units of service provided. Such budgets would create incentives to reduce the level of service provision within a hospital. These reductions in service provision could lead to delays in admitting patients, or to reductions in the use of

effective, but costly, medical technologies.

The health care sector, like all other sectors of the U.S. economy, operates through the individual decisions of producers and consumers. Reforms that fail to directly affect the incentives of these producers and consumers are unlikely to accomplish their goals. Rather, producers and consumers will simply circumvent these regulations, pursuing behaviors that are in their mutual best interest.

SUMMARY

- The Administration's proposal for health care market reform would extend insurance coverage to low-income and middle-income Americans.
- The use of health risk adjusters, advocated in the Administration plan, can reduce differences in the cost of health insurance between people in good health and people in poor health. Unlike community rating plans, health risk adjusters provide incentives for insurers to monitor the utilization of those in poor health as well as those in good health.
- Proposals for health insurance reform that do not incorporate either significant patient payment rates or coordinated care are unlikely to control health care costs.

CONCLUSION

The U.S. health care market provides a very high standard of care to most Americans. The cost of care in this market has, however, been growing very rapidly and many Americans have inadequate health insurance coverage.

As government and employer-provided health insurance have expanded, Americans are paying for a smaller and smaller portion of the cost of their health care out of their own pockets. Because people do not face the full cost of their health care decisions, they overconsume health care services, a behavior called moral hazard. Over time, the quantity, quality, and intensity of services consumed by Americans has been increasing very rapidly.

As the cost of health care rises, many people no longer purchase care. Instead, they rely on their own savings and on the patchwork of acute care services provided by emergency rooms and hospitals. Those with poor health conditions are especially likely to find health insurance available only at very high cost, if at all. Most Americans believe that it is wrong that many poor and unhealthy people must pay substantial amounts to obtain adequate health care.

Experience in other countries and in the U.S. suggests that health care costs cannot be controlled unless people have incentives to regulate their own use of health care services. Such incentives can be provided through the use of deductibles and patient payments. Alternatively, insurers can monitor the

use of care through coordinated care arrangements.

Many plans for reform of the health care market incompletely address the moral hazard problem or other problems, such as the lack of adequate consumer information, that help explain the current state of the health care market. Unless health care costs are controlled, it will be very difficult to ensure that everyone receives at least some basic level of access to care. Only reforms that provide people with appropriate incentives to monitor their consumption of health care services can control costs.

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November 20, 1992

MEMORANDUM FOR DISTRIBUTION BELOW

FROM: MICHAEL J. BOSKIN MJB

SUBJECT: 1993 Economic Report of the President
Chapter 5 -- Agenda for Markets and Regulatory Reform

Attached is a preliminary staff draft of Chapter 5 of the 1993 Economic Report of the President. Please let us have your comments in memo form by noon on Tuesday, November 24. CEA welcomes comments and suggestions and finds them extremely helpful in preparation of the Report.

Comments should be delivered to the attention of J.D. Foster, Room 314, Old Executive Office Building.

Please note that the draft is for official use only, should be held closely, and should not be copied.

Attachment

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CHAPTER 5

AGENDA FOR MARKETS AND REGULATORY REFORM

The U.S. economy relies on the competitive market system to determine what products are produced, how much is consumed and at what price. One primary benefit of competitive markets is that they are flexible and can accommodate change. The developer of an innovative product, for example, will be rewarded if there is a strong demand, which is also a signal that draws additional resources into production to meet that demand. Markets can also reduce the costs of adverse changes. Damage caused by Hurricane Andrew in 1992 temporarily reduced natural gas production by 5 percent. The ensuing price increase for natural gas in part reflected an expected reduction in gas supply from this natural disaster. Price increases both encourage consumers to conserve on the use of a product, and act as a signal to develop new sources of supply for that product.

The U.S. economy is made up of a huge number of well-functioning markets. A competitive market system is the most efficient way of allocating the resources of an economy to meet the needs and wants of the people in that economy. In competitive markets there are a large number of firms producing goods and services, along with a large number of people purchasing those goods and services. Competition drives these firms to produce at the minimum possible cost. Companies that do

not produce efficiently will be forced to charge higher prices. Those companies will lose customers to more efficient competitors and will eventually be driven out of business. Ultimately competitive markets force firms to use that combination of resources (including labor, raw materials and machines) that minimizes the cost of producing a certain level of output.

Markets also coordinate the demands of all consumers in the economy and assure that the quantity of each good produced will match the quantity desired by consumers. The interaction of buyers and sellers leads to an output where the value consumers place on the last unit of output produced equals the value that society forgoes in producing it. This output represents the best choice from the standpoint of the economy as a whole.

Occasionally, however, private markets do not perform well. For example, a private company may not provide sufficient information about risks associated with using its product -- information consumers may need to evaluate product safety. Without regulation of prices or profits, the local telephone company, with no competition, would be free to charge a monopoly price.

The failure of private markets, or "market failure" is a legitimate criterion for determining whether government intervention is necessary. It is not the only criterion,

however. Taking the step towards regulation must be tempered by the understanding that regulation can be at least as imperfect as the market it is trying to improve. There are several reasons for this caution.

First, when the government regulates, it does not always regulate well. While the decision to regulate may be well intentioned, its implementation can have perverse and unintended consequences. For example, by controlling the local telephone company's profits, regulators provide little incentive for the company to improve its quality of service or to reduce its costs. Similarly, requiring costly nutrition labeling could result in the removal of many products from the market, thereby limiting the availability of nutritional products -- the very opposite of the regulator's goal.

Second, because some benefit while others lose from regulation, the regulatory process tends to favor those groups or businesses that can capture the greatest benefits, rather than considering overall societal goals. For example, attempts to amend regulations that restrict competition among international ocean shipping companies have failed, even though the lack of competition translates into higher shipping costs, and hence higher prices for consumers. In many cases this is because the shipping companies, which capture large benefits from reduced competition, are well represented in the rule-making process.

Consumers, being a more dispersed constituency, tend to be overlooked in the rule-making process.

Third, regulation does not accommodate change well. While regulation may be imposed to achieve economic and social goals, it is administered as a legal process. Although the process is designed to consider the views of a diverse public, it often requires years to accommodate the development of new technologies or new ways of doing business. For example, amendments to the Real Estate Settlement Practices Act in 1983 were meant to accommodate the desire of businesses to provide one-stop shopping in real estate settlement services. Yet, the process of actually writing the regulation that implemented the new laws took nearly 9 years. In that period, consumers were denied innovative services from the real estate industry.

The process of developing a rule does not necessarily end at the regulatory agency. Because all legislation requires interpretation, disputes arise as to whether the rule conforms with the legislation's intent. Also, those who stand to lose from a change in the regulatory structure have the incentive to dispute any new rule. Thus, the regulatory process creates an incentive to litigate in the Federal courts. Even after the courts render a decision, the process may have to begin again at the regulatory agency. Excessive litigation makes it harder for the regulatory process to respond to changing industry

circumstances and acts as a drag on the U.S. economy by imposing costs over and above the costs of actually complying with a regulation.

The Administration has sought to apply these lessons in developing a regulatory policy. The central principles of the Administrations's regulatory policy have been (1) to deregulate markets that can be competitive and (2) to only advocate regulations which have benefits that clearly exceed costs; which rely on private markets to achieve their goals; which encourage efficient production of goods and services; which do not discourage innovation; and which provide clarity and certainty for all regulated activities. In 1991, the President initiated the Regulatory Reform Initiative to have all Federal agencies focus on these principles. The results of this initiative are reviewed in this chapter.

The goals of the President's initiative have also been paramount in developing new legislation. The Clean Air Act Amendments of 1990 encourage greater pollution reduction from those electric utilities that are able to do so at the lowest cost. Thus, pollution reduction goals can be reached, but at a savings of billions of dollars over the cost of direct imposition of direct pollution controls on pollution sources. Also, the Energy Policy Act of 1992 contains significant changes in Federal regulation of the electric utility industry. Instead of a

regulator deciding from whom and from where a utility will get its electricity, the act encourages competition in the generation of electricity. Ultimately competition, and not regulation, will reduce the cost of electricity for all consumers and encourage efficient operation of electric utilities.

The lessons of imperfect regulation have also been incorporated into proposals for legal reform. The legal system can constrain economic activity if dispute resolution is slow, outcomes appear arbitrary, or the costs of litigation are high. The Administration's proposed legal reforms are designed to provide a fair but more efficient system of settling disputes. The proposed reforms include: (1) greater access to alternative dispute mechanisms such as private mediation or arbitration, thus enabling matters to be resolved without having to resort to the process required by the traditional court system; (2) limitations on the amount of free discovery, after which the requestor would have to pay discovery costs; (3) capping punitive damages at an amount equal to a plaintiff's actual damages; and (4) discouraging frivolous suits by adoption of the English rule in which the "loser pays." Limited initially to diversity cases, the amount the loser pays would be capped at a level equal to the amount the loser spends on attorney fees.

This chapter sets out an agenda for continuing the progress of reforming how government regulates and of reassessing market

intervention in specific sectors. The first section reviews the regulatory reform initiative, which covers a broad array of regulatory activities. The next two sections discuss the progress of regulatory reform in two traditionally regulated sectors -- telecommunications and financial services. Section four explores private ownership of the right to use a resource as an alternative to government management, as well as more efficient management and pricing of these resources when there is a legitimate case for public ownership. The last section looks at government regulation as one among many risk management systems, including behavioral customs, insurance, the marketplace itself, and the tort system.

CONTINUING THE PROGRESS OF REGULATORY REFORM

Since the mid-1970s substantial progress has been made in reforming the way the Federal Government regulates industry. <u>The outcome of regulatory reform has been both increased price competition and an incentive for companies to introduce new products and to provide service innovations</u>. For example, as a result of deregulation in the airline industry, 43 percent of all trips are now flown in markets with three or more competitors, compared with only 24 percent in 1979. In 1975 the Securities and Exchange Commission eliminated fixed stock brokerage commission rates. In the 6 years following, rates for individual investors dropped by over 20 percent while rates for institutional investors dropped almost 60 percent. Investors can now choose

between discount brokers that simply make stock trades, or brokers that provide complete investor services.

While these cases represent the positive aspects of regulatory reform, there remain instances where the failure to complete the deregulatory process has prevented the full benefits of regulatory reform from being realized. For example, the benefits of increased competition in the domestic airline industry arising from the Airline Deregulation Act of 1978 have not been fully extended to international airline markets. U.S. air carriers continue to be immune from antitrust laws when they use the International Air Transport Association (IATA) as a forum for setting international air fares. The IATA process is essentially a legalized cartel, leading to higher prices and fewer services than would be available in a fully competitive market. Removal of the antitrust immunity by the Department of Transportation would eliminate this impediment to competition.

Indeed, while many of the major examples of regulatory reform over the past 17 years have come as a result of Congressional legislation, Federal, State and local government agencies are often given a great deal of discretion in deciding how to implement the laws. Agencies can devise regulations that make use of private market incentives to achieve regulatory goals, rather than "command-and-control" mechanisms that set

particular technologies or profit levels. Agencies can also use that discretion to encourage competition.

For example, the Cable Television Act of 1984 prevents telephone companies from controlling cable television systems. However, the act allows the Federal Communications Commission (FCC) to exempt telephone companies from this rule in rural areas, where competition from other sources is less likely to develop. In July 1992 the FCC proposed expanding the exemption from areas with fewer than 2,500 residents to areas with fewer than 10,000 residents. Consequently, more rural areas will benefit from the telephone company providing cable services in competition with other providers of television services, such as satellite companies.

The FCC's action came as a part of its review of existing regulations under the President's Regulatory Reform Initiative. <u>The Administration has encouraged all Federal regulatory agencies to review existing regulations and to accelerate action on initiatives that eliminate unnecessary regulations or that otherwise promote economic growth</u>.

THE REGULATORY REFORM INITIATIVE

The Administration instituted the regulatory reform initiative in January 1992. The goal of having Federal agencies review their existing regulations was to (1) revise those

regulations that clearly impose costs that exceed their benefits; (2) ensure that regulations pass a test of cost-effectiveness -- achieving goals at the lowest possible cost; and (3) ensure that, whenever possible, regulations rely on market forces rather than command-and-control requirements. In all, 24 Federal agencies actively participated in the initiative. Over 200 reforms were initiated by the agencies, covering a wide array of government regulatory activities.

First, many of the reforms were designed to reduce the paperwork burden placed on business by regulation. For example, the Internal Revenue Service (IRS) has simplified the rules under which businesses make payroll tax deposits. Under the current rules many employers must make deposits approximately twice a week, but not necessarily on the same two days each week. Under the new regulations, large employers can deposit payroll taxes on fixed days of the week and smaller employers can make deposits monthly. The IRS estimates that these changes are likely to save businesses $400 to $500 million annually.

Second, agencies streamlined the way they conduct their own business. For example, in April the Department of Justice and the Federal Trade Commission jointly issued Horizontal Merger Guidelines. For the first time both agencies explicitly set forth the same standards for deciding whether a merger is anticompetitive. Joint guidelines should result in greater

certainty about the standards to be applied in the over 1,000 antitrust reviews of mergers conducted each year.

Third, agencies worked to promote competition by eliminating unnecessary regulations. The ICC has proposed expanding the size of "commercial zones" for trucking services. Within zones, usually located in metropolitan areas that cross State lines, trucking companies will be free to provide services without obtaining an ICC license. Also, the Department of Housing and Urban Development issued new regulations that implement amendments to the Real Estate Settlement Practices Act. Under the new regulations, real estate companies will have a greater incentive to provide "one-stop shopping" for real estate services such as title insurance or closing services. Real estate companies will still be required to disclose that the various services are being provided by affiliated companies. Competition in the real estate industry, combined with increased use of integrated real estate companies, will result in lower prices for real estate settlement services.

MARKET INCENTIVES AND THE REGULATORY REFORM INITIATIVE

Another objective of the regulatory reform initiative was to encourage the use of regulations that simulate the features of the market by encouraging regulated businesses to produce efficiently. <u>Rather than relying on command-and-control mechanisms, the regulatory reform initiative encourages the</u>

<u>development of regulations that use market incentives to achieve their goals</u>. The following sections discuss three initiatives of this type identified during the regulatory reform initiative. Two of the examples show how the EPA and the Federal Energy Regulatory Commission are using the incentive businesses have to reduce costs as a means of reducing the cost of regulation. The third example represents a proposal under consideration at the Department of Transportation that would provide local airport authorities with guidance on using prices as a method of relieving airport congestion.

<u>Performance Standards in Environmental Regulation</u>

The Clean Air Act Amendments of 1990 require significant reductions of volatile organic compounds and other contributors to air pollution. However, the act does not dictate all of the means required to meet its clean air standards. States and local governments will have to determine how these standards are to be met, with the Environmental Protection Agency (EPA) approving "State Implementation Plans."

The EPA has proposed allowing States to include in their plans the voluntary retirement of pre-1980 model automobiles as a method of pollution abatement. Although pre-1980 vehicles only represent 28.5 percent of registered vehicles, they cause 52.5 percent of hydrocarbon emissions, an important component of smog. One of the most cost-effective ways of reducing emissions is to

replace older vehicles with those cars that emit fewer pollutants. Because industrial polluters would be paying car-owners to remove their old cars from the road, this has become known as the "cash-for-clunkers" program. The program would encourage companies to achieve pollution standards at lower cost.

Consider an industrial polluter that wishes to expand its operations, but the result would be an increase in emissions over an existing performance standard. Under a performance standard based on the level of emissions from an industrial plant, the company would search for the most cost-effective means of reducing pollution. This might occur either by adding new emissions control technology or by adjusting the production process. Yet, an old car operating in the same region as the plant may be contributing equally to pollution. It may be less costly to the company to remove the "clunker" from operation than to reduce emissions at a source that is already regulated.

For example, the cost to the industrial polluter of reducing emissions by some amount may be $1,000 but the owner of an old car that emits the same amount may be willing to sell the vehicle for $500. Under the EPA's proposal the company could use the purchase of an old vehicle as an alternative to directly reducing emissions from the plant. Estimates of vehicle emissions eliminated would be based on a net reduction -- for example, the difference between emissions from the "clunker" and the emissions

from any new car that the seller is likely to purchase. The estimate would be credited to a company as if it had achieved the pollution reduction at its own plant. The EPA's "cash-for-clunker's" program expands the idea of performance standards by permitting the standard to be met through reductions in pollution on sources other than those directly controlled by the polluter. Ultimately, the incentive to meet the performance standard at the lowest cost will determine which method is used to reduce pollution.

Regulation of Natural Gas Pipelines

Natural gas represents 50 percent of the energy consumed in American homes. Interstate natural gas pipelines transport gas across State lines, where it is sold to local gas distribution companies, electric utilities, and industrial users. The Federal Energy Regulatory Commission (FERC) is required by law to approve the prices interstate pipelines charge for transporting gas because, in most cases, purchasers of gas have access to the transportation services of only one pipeline. With a monopoly over gas transportation to particular customers, an unregulated pipeline would have the incentive to raise prices above what they would be in a competitive market.

Where pipelines compete to provide service, regulation is unnecessary, and prices should be determined by the competitive market. While regulation may be necessary in cases where there

is a monopoly provider of services, prices can be set in a manner that gives regulated firms greater incentives to reduce costs and to innovate. As part of the regulatory reform initiative the FERC has adopted a policy under which natural gas pipelines (as well as oil pipelines and electric utilities) can propose alternatives to current regulatory practice that would incorporate "incentive regulation."

Under current practice, all pipelines are regulated using traditional "cost-of-service" regulation. Pipelines provide the FERC with information on costs that they incur in delivering gas, including the cost of building the pipeline facility. The FERC then sets rates to cover those costs, including a return on the capital that is invested in the regulated company.

Cost-of-service regulation places limits on profits as a substitute for the downward pressure on prices that exists in competitive markets. Unfortunately, cost-of-service regulation gives the regulated firm few rewards for cutting costs or for innovating, and few penalties for excessive spending. An attempt to reduce costs will eventually be followed by a reduction in allowable rates, and thus a reduction in total revenues, leaving the firm no better off. Similarly, a service innovation that increases profits would also result in a reduction in rates to bring revenues in line with costs. Cost-of-service regulation thereby reduces the incentive of firms to provide new services.

The distinguishing feature of "incentive regulation" is that it places limitations on prices rather than profit. Setting a price rather than a profit standard separates regulated rates from the cost of production. Once rates are no longer tied to the costs, reductions in costs do not translate into dollar-for-dollar reductions in revenues. Thus, incentive regulation allows regulated companies to retain a portion of the cost savings. In this way regulators limit monopoly profits while giving the regulated company incentives to produce efficiently and to innovate.

One problem in implementing incentive rate regulation is the choice of a price standard. "Price cap" regulation would link a regulated company's allowed rate increases to changes in an index of prices. An index that was related to a pipeline company's own costs would be inappropriate because it would immediately reestablish a link between prices and costs. Rather, the choice should focus on indices over which the company has no control. The Consumer Price Index or the Producer Price Index would be possible choices. To allow consumers to share in the benefits of productivity gains, the index can be adjusted with an offset for productivity.

An alternative to using a price index is to set a performance target for a pipeline. If the company improves upon

the target it benefits in the form of higher profits. Failure to meet the target results in a reduction in profits. One possible target is to set prices equal to the average costs of <u>other</u> similar pipelines. Any pipeline that attempted to lower costs would earn greater profits since its prices would not have to be lowered to reflect the lowering of its own costs. In fact all pipelines would want to lower costs under this system. Any pipeline that did not would eventually find itself with prices targeted to industry costs that are lower than its own costs. This form of incentive regulation is often called "yardstick competition" because firms are forced to compete on the basis of their levels of efficiency even though they do not directly compete in the transportation of natural gas.

Using the price cap method, incentive regulation has been employed effectively in the FCC's regulation of AT&T's long-distance services. The problem with price caps as a long-run approach is that it uses current prices as the base rate to which the index is applied. As costs change over time, the continued use of the same index could lead to firms earning large profits or suffering large losses. This is not a critical problem in the case of AT&T, which is in a transition to full deregulation. Most pipelines, however, are unlikely to face competition in the near future, making regulation necessary. <u>Thus, the yardstick may be superior to price caps because it would ensure that a pipeline's rates were constantly tied to a reasonable level of</u>

costs. In effect, pipelines would be constantly competing on the basis of efficiency.

Reducing Congestion at Airports

Every day, consumers face prices for services that depend on the time of day or the season that they are used. The price of a typical long-distance telephone call is 24 cents per minute during the day, when usage is high, compared to 13 cents late at night when usage is low. Movie tickets are higher during evening hours, when demand for service is high, but often lower at other hours when seats go unused. What these products have in common is a fixed capacity for providing a service, but a pattern of usage that varies throughout the day. In each case reliance is placed on prices to reflect the service's high value in periods of peak demand.

Airports are in a similar situation, with a fixed capacity to handle takeoffs and landings. Insufficient airport capacity to meet the near doubling in revenue passenger miles flown since deregulation is resulting in greater delays throughout the system. Approximately one-third of delays result from peak demands that exceed the capacity of air traffic control and runways. Thus, some of the benefits of deregulation are being lost due to inefficient use of the Nation's airport infrastructure. Although in the long-run capacity needs can be met by additional runway construction, the existing system can be

used more efficiently. Yet time-based fees or "peak/off-peak" prices, used regularly by electric utilities and telephone companies, are not commonly used by airports.

In fact, the typical airport landing fee is based on the weight of the airplane that is using the runway. While basing fees on weight is meant to act as a proxy for the cost to the airport of servicing an airplane flight (e.g., in terms of space used and wear-and-tear on the runway), such fees fail to allocate scarce runway resources efficiently during periods of high demand.

<u>Instead, prices should reflect all costs, including congestion costs, such that only those who value airport use highly will use that airport at that time. In that way congestion will be reduced</u>. Consider an airport that has periods of very intense use, resulting in delays, and periods of excess capacity. During periods of slack demand, when the airport has extra capacity, a takeoff or landing will not cause congestion. The appropriate landing fee is one that merely reflects the actual costs of providing the service.

If too many flights are added to the schedule, however, delays will appear. Each flight results in delays for all other carriers attempting to use the airport. If landing fees only reflect direct costs of providing services, then the price will

not convey to carriers the costs of congestion. Consequently, the airport will be overutilized, given its level of capacity.

By including the costs of delay, a peak-load price system can efficiently allocate airport space. Those flights that serve passengers who are willing to pay the high cost of flying at a peak take-off time will not move to other, less crowded, times. For some flights, however, the price will be high enough to encourage a shift of schedules away from the peak period. The price system makes congestion costs explicit, so that only those placing the highest value on peak service will use the airport, relieving the level of congestion. Without a peak/off-peak pricing system passengers will still "pay" the costs of congestion, but it will be in the form of long waiting times and takeoff delays.

SUMMARY

- The goal of the President's regulatory reform initiative is to deregulate markets that are competitive and to advocate regulation only when the benefits of regulation clearly exceed the costs.
- Regulations that incorporate market-based incentives will achieve regulatory goals at lower cost than command-and-control methods.

- Setting appropriate prices for the use of the Nation's infrastructure, such as airports, will assure that these resources are being used in the most efficient manner.

TELECOMMUNICATIONS: REGULATORY REFORM AND INNOVATION

One industry that has received particular attention during the regulatory reform initiative is telecommunications. The telecommunications industry is a broad sector encompassing telephone and satellite services, information services, broadcasting, and manufacturing of equipment. Rapid technological change and regulatory reform in telecommunications has brought an increased level of choice and quality in entertainment, information and communications to American consumers and businesses. In the past, for example, many Americans could only receive three television channels; now access to 50 channels is not uncommon. The venerable "phone company" has been transformed into a multiplicity of telecommunications entrepreneurs, and a competitive market for many telephone services has developed.

While some parts of the industry are vigorously competitive, others remain tightly regulated. There is a legitimate concern that without regulation consumers will not be protected from monopoly pricing and competition will be harmed. Insufficient weight, however, has been placed both on the fact that regulation itself is imperfect and on the hidden costs of foregone product

innovation and inefficient production that result from regulation. The goal of this Administration has been to reform the regulatory structure so that consumers receive the benefits of new products and services, while maintaining the safeguards necessary to protect them in cases where markets are not fully competitive.

TELECOMMUNICATIONS AND THE U.S. ECONOMY

The telecommunications industry comprises thousands of businesses and over one million workers. Traditional telephone services alone, including long distance, local, satellite and cellular are provided by over 2,000 companies employing 890,000 people -- more than are employed in manufacturing automobiles in the United States. In 1991 domestic long-distance revenues were $49 billion and local telephone revenues were $93 billion. Interstate long-distance communications is a particularly high-growth component, with calling volume doubling since 1984. The television and radio broadcasting alone earned $37 billion in advertising revenue for 1990. This includes approximately 1,500 broadcast television stations, 11,000 radio stations and over 130 cable television networks.

One measure of overall performance in the telecommunications industry is productivity. Even with significant deregulation in the United States, the telephone services sector in more heavily regulated France and Japan have the same levels of labor

productivity as the United States. The primary reason is that 70 percent of the employees in the United States still work for the regulated local telephone monopolies. The competitive pressure to improve efficiency has, until recently, been absent in this sector. Traditional rate-of-return regulation does not encourage labor productivity improvements through cost cutting. In the virtually deregulated long-distance sector, however, when faced with competition from MCI and Sprint, AT&T reduced employment about 25 percent between 1984 and 1990, despite the fact that AT&T's total calling minutes increased 58 percent. Over the same period employment in the regulated local telephone sector remained the same.

Where the United States does hold a lead is in the level of capital productivity. A recent study estimates that calls per dollar invested in the network are 2.4 in the U.S., versus 1.3 in Japan, 1.2 in the U.K., and only 0.6 in France and Germany. The U.S. lead is primarily the result of higher demand for telephone services and thus higher utilization of the network. In part, demand has been stimulated by long-distance competition and pricing policies that have lowered long-distance rates closer to the cost of actually providing the service.

Even with evidence showing efficient utilization of the telephone network, some have called for large public expenditures on the U.S. telecommunications infrastructure, such as by

expanding the use of fiber optic cable. Yet, it is regulation that prevents firms with telecommunications expertise from investing in new infrastructure. <u>Absent regulatory barriers, competition and the ability of firms to reap the rewards of their success provide sufficient incentive to produce commercially viable telecommunications technologies</u>. Only for basic research and for technologies in the early stages of development are the rewards not easily captured by any one firm, thereby reducing the incentive to invest. In this limited circumstance, government has an appropriate role in directly funding research and development.

In general, however, public investments in particular commercial technologies amount to an attempt by the government to second guess which products have a market demand and what are the best ways of producing them. High Definition Television (HDTV) provides a good example of this problem. The Japanese government determined which technology would be used for HDTV in their country, and financed a consortium to promote its development. It now appears, however, that the government-chosen technology was inferior. Left to its own, U.S. industry has developed an alternative to Japanese HDTV using digital technology that appears superior in quality. <u>Rather than having taxpayers invest in technologies chosen by the government, promoting a more sensible regulatory environment will ensure continued</u>

productivity improvements and the development of advanced communications technologies.

REGULATION AND GUIDELINES FOR REFORM IN TELECOMMUNICATIONS

Today, technological innovations are making competition feasible where it was previously considered unfeasible. For example, Bell Atlantic has announced that it will soon have the technology to deliver feature films over their existing copper wires. Conversely, cable television companies could provide customers with telephone service on the same lines that carry television signals. The full benefits of these changes will be lost if government policy maintains a regulatory structure that restricts competition and preserves artificial industry boundaries. Below are guidelines for government policy that accommodate continuing innovation and change in this industry.

The Current Structure of Telecommunications Regulation

The U.S. telecommunications industry is governed by a web of Federal, State, and local regulatory commissions, with a special role played by the Federal courts. The FCC is the principal Federal regulatory agency governing telecommunications in the United States. The Commission is responsible for regulation of interstate and international long-distance telephone services, managing the U.S. radio spectrum, enforcing rules governing the broadcasting industry, and establishing standards.

A complicating factor in the Federal regulatory structure is the 1982 court settlement of the Federal Government's antitrust case against AT&T. This settlement, or consent decree, governed the subsequent breakup of American Telephone and Telegraph (AT&T). Under the decree, AT&T had to divest itself of its 22 local telephone companies. The companies were then formed into seven independent companies, called regional Bell Operating Companies (BOCs). Also, the decree limits the products that the BOCs are permitted to make and bars AT&T from providing local telephone service. Although some of these restrictions have been lifted, applications for interpretations and waivers from the remaining restrictions establish a constant role for the Federal courts as a second Federal regulatory agency.

State regulatory commissions have responsibility for regulation of intrastate telephone services. But there is extensive interaction between State regulators and the FCC because the same equipment is often used to provide interstate and intrastate service. For example, the same switch that handles calls from San Francisco to Los Angeles may also handle calls from San Francisco to Phoenix. Yet, the first call is regulated by the State government, and the second by the FCC. A system of rules and joint boards has been developed to help separate the Federal and State roles. The role of local government has generally been to franchise cable television

service. The local role in Cable television rate regulation will be expanded by the Cable Television Act of 1992.

The Transition to Deregulation

One primary justification for limiting competition in the telecommunications industry has been the belief that certain services had the characteristic of "natural monopolies." That is, where a single supplier can most efficiently meet consumer needs, regulation of prices and the number of competitors may be desirable. Thus, cable television services and local telephone services have been limited to a single company in a particular community.

But relying on monopoly franchising and rate regulation can also have drawbacks. First, government protection of a monopoly may prevent potential competitors from implementing technologies that do not have the cost characteristics of a natural monopoly. For many years regulators considered long-distance telephone service to be a natural monopoly. The development of microwave technology allowed the provision of long-distance telephone service on a much smaller scale than was previously possible. Several firms now provide long-distance services, some on a national scale, while others serve specialized business customers. New transmission technologies may achieve similar results in other perceived natural monopoly markets such as cable television and local telephone service.

Second, competition itself will drive firms to innovate and provide new services. <u>In many telecommunications markets the benefits of competition are superior to the continuation of rate regulation and monopoly franchises because competition will both lower prices and increase the diversity of service offerings</u>. Even in the case of natural monopoly, perpetuating its existence may do more harm in the form of lost opportunities for innovation than good in deterring duplication of services.

<u>Protecting Consumers in the Transition</u>

Markets in which competition has been precluded by governmental entry barriers cannot be expected to become competitive overnight. For example, in the case of local telephone service significant capital expenditures are required for firms to provide competing services. As a result, where changing technology and removal of governmental regulation makes it possible for a regulated monopoly market to evolve into a competitive market, consumers must be protected from unwarranted price increases during the transition to competition.

As part of the transition to deregulation, "incentive regulation" is being used to promote more efficient operations by regulated companies. In many areas, regulation has been used to enforce a system of cross-subsidies which keep prices low for certain classes of users -- such as residential telephone

subscribers and rural subscribers (see box 5-1). During a transition period -- or longer if the subsidies are justified -- these cross-subsidies should be replaced by direct subsidies which do not distort the overall price structure.

Box 5-1. -- If Deregulation Is So Great, Why Has My Phone Bill Gone Up?

When a telephone call is made across the country, a local phone company starts the call, a different local company completes the call, and a long-distance company, such as AT&T, carries the call between the two areas. Thus, the local phone network plays two roles -- providing phone service in a local area and providing access to one of many competing long-distance phone companies. Prior to 1984, AT&T, with its near monopoly over long-distance and local telephone service carried virtually all of these phone calls. To determine the price of a long-distance versus a local call, Federal and State regulators had to allocate some of the costs of the local network to long-distance calls. If a higher share of the costs were attributed to long-distance calling, long-distance prices would be higher, and local service prices would be lower.

Political pressures resulted in a shift of costs to the long-distance portion of the telephone network, such that local rates were kept artificially low relative to costs. The regulatory shift of costs resulted in prices that led to an inefficient use of the network, however. The cost of providing a customer access to a long-distance company is a <u>fixed cost</u>, unrelated to how many long-distance minutes are used. However, these fixed costs were reflected in the per minute charge for service, a price that should only reflect the extra, or <u>marginal cost</u>, of providing the service. The higher long-distance rates resulting from this policy caused users to reduce long-distance calling and prompted the entry of companies such as MCI.

Realizing the inefficiencies resulting from this pricing policy, the FCC began pricing reform in the 1970s. Instead of reflecting the cost of access in long-distance prices, some of these costs are now recovered through a fixed monthly <u>subscriber line charge</u> that is added to the monthly local telephone bill. For residential customers, the FCC has been gradually shifting access costs to the subscriber line charge since 1983. The monthly price for local telephone service, increased 3.1 percent annually between 1983 and 1989, in real terms. For some this has meant higher phone bills. But interstate long-distance prices <u>declined</u> 9.8 percent annually in the same period. That decline

is due to the combination of competition, the repricing of access and technological improvements.

Where deregulatory policies result in partially deregulated firms or allow regulated firms to enter unregulated markets, additional safeguards may be necessary to protect consumers and competition. Because telephone rates in some States are determined by cost-of-service regulation, safeguards are necessary to ensure that the customers of regulated firms do not subsidize the activities of these firms in unregulated markets. The incentive to transfer costs to the regulated sector results in inflated prices for telephone service and places competitors in the unregulated markets at a disadvantage. Safeguards are also necessary to ensure that telephone companies do not use their knowledge of the local network, or design the network in ways that discriminate against companies in related but unregulated industries.

[Section on THE FUTURE OF TELECOMMUNICATIONS REGULATION to be added]

SUMMARY

- Regulations that allow regulated firms to compete in new lines of business, while protecting consumers, will promote the continuing development of an advanced telecommunications infrastructure.

THE REGULATION OF FINANCIAL MARKETS AND SERVICES

Well-functioning financial markets are essential for growth and prosperity in a modern market economy. New and expanding business enterprises need capital to make investments and create jobs. They rely on the futures, options, and foreign exchange markets to control unwanted risks. Families and businesses buy insurance to shield themselves from catastrophic losses. Well-developed mortgage markets foster wide-spread home ownership.

As in the telecommunications markets, financial markets are subject to a wide variety of government regulations. Here too, we find cases of unnecessary, outmoded, and overly rigid regulations. The U.S. financial markets are the largest and most developed in the world. The continued success of these markets depends critically on the ability of regulators to remove unnecessary regulatory impediments, while continuing to preserve investor protection and maintain market integrity. This section reviews some important recent developments in the financial markets, and describes the Administration's proposals for regulatory reforms that will ensure that we maintain our competitive position and that the availability of these services will continue to grow.

THE CHANGING FINANCIAL SCENE

The last 20 years have witnessed an explosion in the scope, complexity, and internationalization of financial markets. The

products. They associate what they view as increased volatility of financial markets with these changes. Several highly publicized cases of fraud have brought the integrity of some markets into question. However, private and regulatory mechanisms have been put into place to identify problems as they arise and to promptly correct them. Most observers would agree that on balance these advances have been extremely beneficial.

THE VALUE OF FINANCIAL SERVICES

Despite their seeming complexity, most of these instruments and institutions can be understood in terms of three basic functions. First, people use financial markets to reallocate money over time. For instance, instruments such as savings accounts, Investment Retirement Accounts (IRAs), stocks, bonds and pension funds allow households to save for retirement. These same instruments channel funds to those who choose to borrow and later repay their debts.

Second, people use financial contracts to share and reduce risk. An insurance policy is perhaps the most familiar example of a risk-reducing financial contract, but most new financial instruments are tools for risk management as well. One extremely effective way to reduce risk is through diversification. The return on a diversified stock portfolio is much less risky than the return on an individual stock because some companies are likely to prosper just when others fail. A stock market mutual

fund is an innovation that pools the cash of many investors to purchase a diversified portfolio of stocks. Small investors are thereby able to balance risk and return using tools that were only available to large institutional investors or wealthy individuals in the past.

Risk can also be effectively reduced by well-designed contracts. For instance, a U.S. manufacturer selling cars in France bears the risk that the value of the francs received next year will fall relative to the value of the dollar. A French farmer selling cheese in the U.S. faces the opposite risk. Both can eliminate this source of risk by writing a "forward contract" that specifies the rate at which they will exchange dollars for francs at a set future date. The growth of active forward and futures markets has significantly lowered the costs of writing such contracts.

The third function of financial markets is to provide liquidity. An asset is liquid if it can be bought or sold quickly and with little expense. A savings account is very liquid because it can be turned into cash almost instantly. A house, on the other hand, requires weeks or months to sell and hence is quite illiquid. By creating standardized contracts with well-understood characteristics, financial intermediaries enhance liquidity and thereby lower transactions costs for investors and borrowers alike.

The ability of financial markets to invent, develop and market new financial instruments has also improved the ability of the macroeconomy to adapt to constantly-changing conditions, and to weather external shocks. Even in an economic expansion, particular industries and geographic regions experience significant economic disruptions. For instance, in the mid-1980s disinflation hurt the farm sector by driving down the price of agricultural products. The existence of active futures markets blunted the impact of the price drop, because it allowed farmers to lock in prices for their products months or even years before the commodities were to be delivered. Similarly, the collapse of energy prices in 1986 hurt U.S. energy producers, and the sharp rise of the dollar in the early 1980s hurt manufacturing industries. All of these episodes would have had a substantially more severe impact in the absence of active forward and futures markets in agricultural products, oil and foreign exchange.

THE CHANGING ROLE OF GOVERNMENT

As financial markets have evolved, so has the nature of Government involvement. The history of government intervention in financial markets contains many useful lessons about the circumstances in which intervention may be appropriate, and about the problems that can be caused by poorly designed intervention. Here we will consider financial market regulation in historical

perspective, and discuss some of the challenges for regulatory reform.

Historical Overview

Despite the many new developments discussed above, much of the regulatory structure governing the financial sector dates from the 1930s. The disruptive waves of bank failures throughout the 1800s and early this century, culminating in the Great Depression, convinced legislators that the stability of the real economy depends on the stability of the banking system. Institutions such as Federal deposit insurance and the legal separation of investment and commercial banking (the Glass-Steagall Act) date from this period. Despite some initial doubts expressed by the framers of this regulatory structure, until the late 1970s calm prevailed in the financial markets, and the regulatory system was widely considered to be a success.

The high and volatile interest rates in the late 1970s began to expose some of the underlying weaknesses of the system. The heavy losses suffered by the savings and loan industry set the stage for the current savings and loan failures. Commercial banks fared somewhat better, but some were adversely affected as depositors withdrew their funds to seek higher market returns. On the whole, the regulatory reforms of the early 1980s removed some of the obvious impediments to bank operations in this new environment, but did little to address many of the fundamental

problems in the regulatory structure. This issue is discussed in detail below.

The Role of the Government in Financial Markets

The growth of financial services has been accompanied by a sharp increase in Government involvement in many of these activities. Is the large and expanding role of the Federal Government in these markets on net beneficial? To evaluate this important and complex issue, it is useful to start with the more basic question, what current or potential market failures require government intervention to be corrected? There are two areas in which most observers agree that regulation should have a role.

The first is to maintain the stability of the credit and payments system. The financial market acts as the circulatory system of the economy, creating a vital connection between seemingly unrelated enterprises. When this system breaks down, even healthy sectors of the economy are likely to suffer. The most compelling example of this remains the massive upheavals caused by the contraction of credit during the Great Depression.

Government institutions such as deposit insurance and the Federal Reserve System serves to limit the damage caused by a financial crisis by providing an emergency source of liquidity, and by preventing financial panics from spreading. To take a more recent example, during the October 1987 stock market crash

the Federal Reserve extended additional credit to banks to provide emergency loans. These loans allowed many financial firms to avoid bankruptcy, and some have credited these measures with preventing more widespread repercussions from the crash.

A second role for regulation of financial markets is to improve the day to day operation of the market by providing prudent oversight to prevent fraud and abuse, and by facilitating disclosure of truthful information important to the successful performance of contracts. For example, State insurance boards audit the investments of life insurance companies, and the SEC requires corporations financed with publicly traded stocks or bonds to disclose relevant financial information.

As discussed above, the existence of a market imperfection does not in itself justify government action. To be justified, regulation must also pass a rigorous social cost benefit test and be carefully designed to provide strong incentives for efficiency. Otherwise, the cure may be worse than the disease. This caution is particularly important in the context of government insurance programs, which are discussed in more detail below. While these programs may help to reduce risk, they also reduce the incentive for the insured party to take prudent measures to avoid losses. This moral hazard problem has led to multi-billion dollar losses to taxpayers, and the hidden costs of

misallocated resources may be even greater (see Chapter 6 for more detail on the size of these liabilities).

Challenges for Regulatory Reform

The dynamism of the financial marketplace presents a special challenge to regulators. When a rule becomes particularly onerous, someone is likely to invent a way to avoid it. This may have unfortunate and unintended consequences. For instance, in the late 1970s banks were prohibited by regulation (known as Regulation Q) from paying depositors more than the maximum rate of 5 percent on their savings accounts. Interest rates rose well above this rate ceiling, causing depositors to move their money into newly created, high yielding mutual funds. The large drop in deposit levels ultimately hurt smaller businesses that could not easily switch to borrowing in the open market. Ironically, one of the original reasons for imposing interest rate ceilings was to lower the cost of funds for banks. The lesson has been that effective regulation must be flexible, and oriented towards broadly creating the right incentives for fair and efficient operations. Rigid command and control type rules can cripple the ability of the market to provide valuable services, and almost inevitably result in an unproductive game of regulatory catch-up.

In designing effective policies, regulators must also take into account the internationalization of financial services.

Large U.S. banks have operations on every continent, while domestic banks face competition at home from U.S. branches of foreign banks. Many stocks that once were traded exclusively in New York now also are traded in London and Tokyo. Securities change hands around the clock and around the world via new electronic trading systems. These advances have lowered the cost of raising capital for U.S. businesses and the Federal Government, and have opened up new investment opportunities for U.S. investors.

The internationalization of markets has also made these markets extremely competitive and mobile. Policymakers worldwide have become increasingly aware that coordination is necessary to create a level playing field, and to maintain stability and accountability. Because these markets are mobile, countries that unilaterally impose costly regulations risk sending business overseas. An example of such a policy would be to impose a tax on stock or futures market transactions. While revenue might be increased in the short-run, the long-run effect would likely be little tax revenue and many lost jobs.

Finally, an unfortunate consequence of the piecemeal process of financial regulation and reform has been that the responsibility for regulating the financial markets is spread across a large number of Federal regulatory agencies. The Federal Reserve, Treasury, Federal Deposit Insurance Corporation

(FDIC), Office of Thrift Supervision (OTS), Securities and Exchange Commission (SEC), and Commodity Futures Trading Commission (CFTC) often find themselves with overlapping jurisdictions, especially as banks widen their participation in the securities markets and new financial instruments fall across what once were distinct categories. In some cases, conflicts between agencies have actually prevented viable financial products from being made available to the public. For instance, a jurisdictional conflict between the CFTC and the SEC has prevented certain types of futures contracts, called "index participations," from being traded, despite evidence of a strong demand for these products. Coordination or consolidation of rulemaking authority could significantly reduce the unnecessary regulatory burden imposed by inconsistent rules and reporting requirements, while elimination of duplicative staffs would lower administrative costs.

CURRENT ISSUES IN REGULATORY REFORM

Having touched on the broad principles governing the appropriate design of financial market regulation, we turn now to recent regulatory developments in the areas of depository institutions (banks and savings and loans) and insurance markets.

Lessons From the Savings and Loan Debacle

Since 1980, regulators have shut down almost 1200 insolvent savings and loan institutions (S&Ls), with assets of over $500

billion. Another 50-100 S&Ls are expected to fail over the next few years. This wave of S&L failures will ultimately cost taxpayers $111 billion (1989 dollars) of projected total losses. Because of Federal deposit insurance, however, no insured depositor has lost a dime.

It is important to understand the underlying causes of these failures so that losses of this magnitude can be avoided in the future. The troubles of the S&Ls began when the high interest rates in the inflationary 1970s wiped out about a quarter to a third of the value of the long term, fixed rate mortgages that were their primary assets. As interest rates rose, the cost of the short-term deposits used to finance the mortgages increased, but the mortgage payments remained constant. By 1980, the total value of liabilities exceeded the total value of assets; S&Ls as a group were bankrupt.

Although regulators were aware of the problems, they chose to allow many insolvent S&Ls to continue operating. When a private company nears bankruptcy, operations are severely limited because investors refuse to provide further financing. With deposit insurance, however, depositors have no incentive to withdraw their funds; there is no natural market mechanism to limit the activities of insolvent S&Ls. In fact, regulations restricting investment to traditional mortgage lending were relaxed to make the S&Ls more competitive with commercial banks.

With nothing left to lose, many S&Ls used their insured deposits to gamble on high risk investments in areas outside their scope of expertise. If these investments paid off, the financial health of the S&Ls would be restored. If they failed, the deposit insurer, and ultimately the taxpayers, would pay the costs.

There are several important lessons to be learned from this episode. First, deposit insurance can encourage excessive risk-taking behavior by depository institutions. This not only leads to large taxpayer liabilities, but also to real economic losses through the inefficient use of private capital. As long as the Government provides deposit insurance, some regulation will be necessary. Well-designed regulations must counterbalance these incentives, but with minimal interference in the operations of well-managed institutions.

A second lesson regards the workings of the regulatory system. Perhaps the most disquieting revelation was that Congress and the regulators were aware of the problems but chose not to act. The "prompt closure" provision of the recently passed Federal Deposit Insurance Corporation Improvement Act (FDICIA) is an attempt to solve this problem by obligating regulators to quickly close down banks with insufficient capital, as discussed below.

Although most insolvent S&Ls have now been closed, a number of problems remain. The Resolution Trust Corporation (RTC) is the Federal agency in charge of closing insolvent S&Ls, paying off depositors, and recovering as much as possible by liquidating remaining assets. The RTC can only perform these activities if it has money with which to pay off depositors. As of this writing, the RTC has exhausted its funds. As a result, insolvent institutions continue to operate and continue to lose money at an alarming rate. The Administration has urged prompt action, but until Congress appropriates more funding these avoidable costs will continue to mount.

Healthy savings and loans are still exposed to substantial losses if interest rates rise, because they continue to finance long-term mortgages with short-term deposits. A rapid increase in interest rates would cause funding costs to rise, while income would be largely fixed. The maturity mismatch between S&L assets and liabilities is a consequence of regulation rather than market forces. It is doubtful that these rules still make sense, particularly because alternative means of financing mortgages that avoid this source of risk have developed.

Several regulatory steps have been taken to better protect the Savings Association Insurance Fund (SAIF) from future losses, as will be discussed in more detail below. Most notably, legislation has increased the capital requirements for S&Ls from

approximately 3 percent to 8 percent, making them comparable to the requirements for commercial banks.

Developments In Commercial Banking

A variety of difficulties have also weakened commercial banks, as discussed extensively in Chapter 3. The unusually large number of bank failures in recent years has left the bank insurance fund with insufficient funds to pay for anticipated future losses. Based on OMB estimates, losses net of premiums will total $32 billion in fiscal years 1992 to 1997. Taxpayers are unlikely to be called upon to make up the deficiency, except indirectly due to the increase in deposit insurance premiums. To cover near-term costs, the FDIC is authorized to borrow up to $70 billion from the Treasury. It is anticipated that this debt will be repaid using future deposit insurance premiums.

The Impact of FDICIA

In December 1991 Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA). FDICIA is the most recent major legislative attempt to reform the rules governing depository institutions. Its primary goal was to decrease future losses from deposit insurance, both by tightening supervisory standards and by increasing insurance premium rates and capital requirements for riskier institutions. It also provided some of the much-needed additional funds to finish closing insolvent banks and savings and loans.

Unfortunately, FDICIA created several new problems of its own. The Administration has introduced legislation that would repeal several of the supervisory provisions that impose unreasonably high compliance costs on banks, and that do little to improve the soundness of the system.

Poor implementation of the FDICIA requirement to establish risk-based capital standards may have contributed to the unusually tight credit conditions of the past few years. Conceptually, bank capital is the difference between the value of a bank's assets and its liabilities. Bank capital provides a cushion against losses to the FDIC, so it is appropriate that the capital requirement reflect the risk of a bank's assets. However, for such a rule to provide the appropriate incentives, it must set a capital standard that reflects all types of risk. The current risk-based capital requirement only takes default risk into account. As a result, banks shifted away from investing in commercial loans towards investing in Treasury securities. This substitution decreased exposure to default risk, but increased exposure to losses from depreciation in the value of Treasury securities due to future increases in interest rates, or interest rate risk. The current Administration proposal to implement a risk-based capital standard that also recognizes interest rate and other types of risk will correct this unintended distortion.

FDICIA addressed the problem of lax regulation of weak institutions by instituting a "prompt closure" rule. This rule requires that the FDIC restrict a bank's activities if its capital falls below specified levels. For the most severely undercapitalized banks, the law requires closure within 90 days. The purpose of this regulation is to avoid the long delays and speculative losses that have added billions of dollars to the cost of the thrift crisis. The drawback is that bank capital is often poorly measured, so there is the risk that some healthy institutions will be unfairly constrained.

Bank supervisors rely heavily on accounting data to determine the strength of individual banks. The need for reliable data is amplified by regulations such as this new "prompt closure" rule. Discrepancies between true and reported asset values occur because the reported value, or book value, does not necessarily reflect current market conditions. For instance, a loan can be known to be bad for some time before a bank must recognize the loss. Conversely, regulators do not take into account the true value of bank assets which have appreciated.

Some observers have proposed adopting a system of market value accounting, whereby banks would report market values instead of, or in addition to, book values for their assets and

liabilities. While in principle market value accounting would increase the quality of information available to regulators, in practice it is difficult to determine the market value for infrequently traded assets such as some types of commercial loans. Regulators appear to be moving towards a system that places more emphasis on market values than in the past, but still relies primarily on book values.

Administration Proposals for Further Bank Reform

FDICIA failed to address many of the fundamental problems in the current regulatory structure. In 1991, the Administration proposed a broader set of regulatory reforms that would significantly improve the efficiency of our financial system. Since the 1991 Report described these proposals in detail, here they are only reviewed briefly.

The Administration supports the removal of branch banking regulations that limit interstate banking. Although such rules were originally enacted with the idea that they would reduce the potential power of large banks, today they have the opposite effect of decreasing competition between banks in local markets, and thereby increasing the cost of bank services. Interstate banking would also make banks safer because they could diversify their risks geographically and increase their profitability by avoiding costly legal barriers to efficient operation.

Currently the FDIC insures deposits up to $100,000, and wealthy individuals can obtain unlimited insurance by splitting deposits between many separate accounts. Capping the maximum insurance coverage for a single individual would reduce the government's liability, while still providing ample protection for the savings of small depositors. An added benefit would be that large depositors would have an incentive to monitor banks to ensure that they followed sound investment strategies.

Finally, the Administration supports a number of reforms that would remove unnecessary impediments to bank provision of financial services. Banks are currently prohibited from such activities as selling insurance and underwriting new stock and bond issues. These services are complementary to traditional banking activities. Allowing banks to participate would lower costs to the public, and would improve the profitability of banks.

Government-Sponsored Enterprises -- The New Goliaths

With little public fanfare, the mortgage market has undergone an enormous structural change. In 1975, S&Ls financed 56 percent of single family mortgages. By 1991, this share had shrunk to 18.4 percent. Much of the private market has shifted to two Government-Sponsored Enterprises (GSEs), the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Bank Board (Freddie Mac). A third housing GSE, the

Government National Mortgage Association (Ginnie Mae), finances mortgages guaranteed by the Veterans Administration and the Federal Housing Authority. (Chart 5-1 shows the relative mortgage holdings of S&Ls, commercial banks, and these GSEs since 1975.)

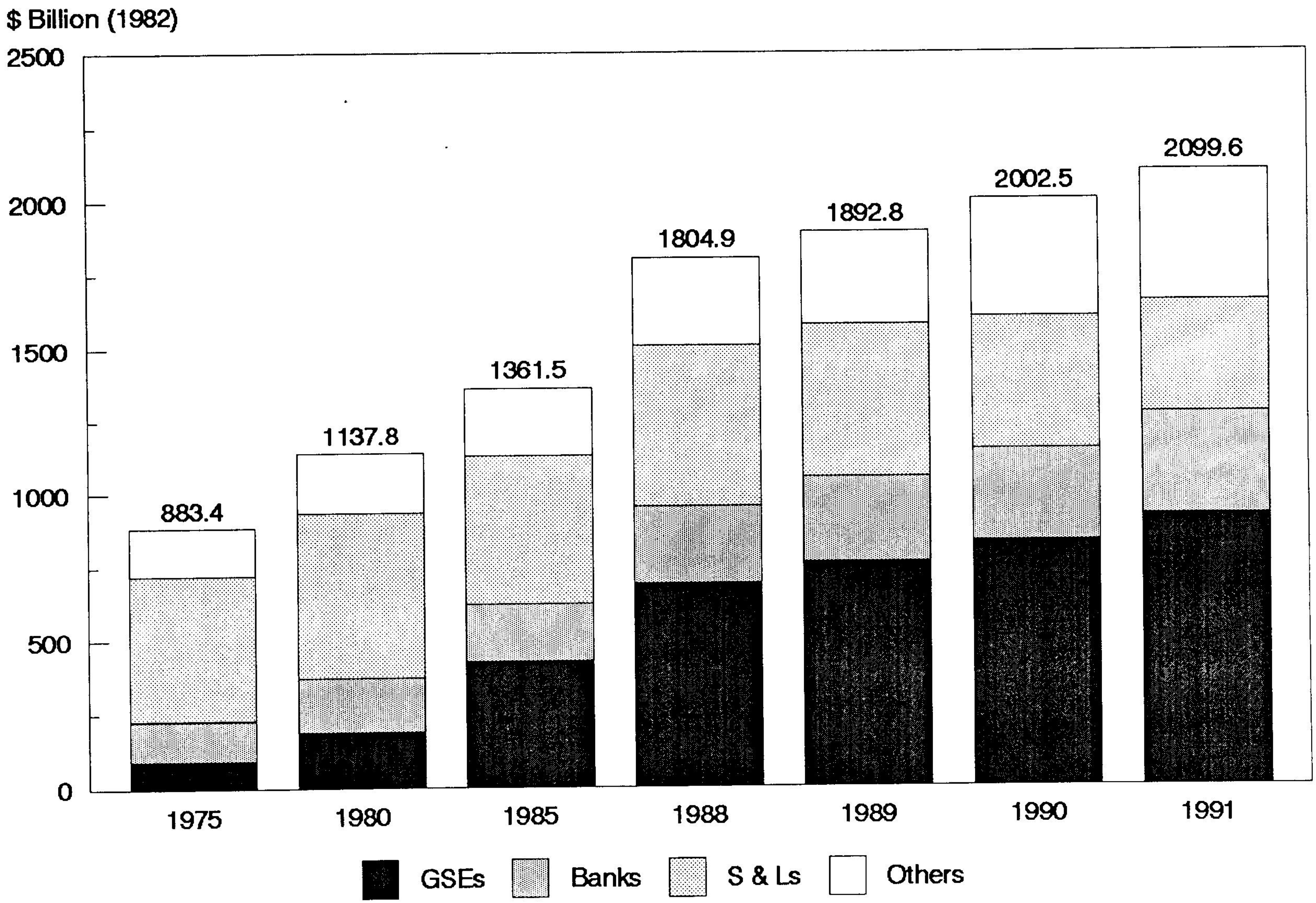
Unlike the banks and S&Ls, the GSEs remain largely unregulated. This is somewhat surprising given their central role in the housing market, and the growing government liability from the implicit guarantees attached to GSE securities. This section discusses the function of the GSEs, the significance of the government guarantees, and the regulatory issues surrounding these institutions.

Fannie Mae and Freddie Mac are privately funded businesses that buy, repackage, and resell mortgages. Homebuyers still apply for mortgages at traditional lending institutions, for example, at an S&L. The S&L makes and often services the loan, but rather than funding the loan with deposits, it sells the loan to a GSE. The GSE either repackages and sells the loan again, or keeps it in its portfolio and sells securities to finance it.

Securities issued by the GSEs bear an implicit Federal guarantee. That is, the market expects that if the GSEs were unable to meet their obligations due to a fall in the value of their mortgage holdings, the government would make the payments. The guarantee is implicit in the sense that although these

Chart 5-1 **Single-Family Mortgage Debt Outstanding**

The principal source of single-family mortgages has shifted from saving and loan institutions to government sponsored agencies.



Source: Federal Reserve Bulletin.

enterprises have a Federal charter, the government has no legal obligation to cover GSE losses. Nevertheless, investors appear confident that a guarantee exists. This is evidenced by the fact that investors accept returns on GSE securities that are only slightly higher than those on Treasury securities of similar maturity.

The implicit government guarantee lowers the cost of mortgage financing by removing default risk. GSEs also lower the cost of mortgage financing by enhancing the liquidity of mortgage loans. One way they do this is by reducing uncertainty about when the loan will be repaid, through a process known as securitization. Fannie Mae and Freddie Mac securitize mortgage loans by gathering them into diversified pools which have fairly predictable repayment characteristics. They issue securities, backed by these mortgage pools, and sell them to a broad group of investors such as banks, insurance companies, pension funds, and mutual funds.

<u>Although the government removes default risk for the purchaser of an insured security, it cannot eliminate the fundamental default risk which is inherent in the investment activity being funded</u>. The percentage of bad loans may actually increase when loans are insured and resold, because the incentive to monitor the ultimate borrower is removed. While the S&Ls suffered the consequences of their lending decisions, the

mortgages resold by the GSEs are "originated" by institutions that ultimately have a small stake in whether the loans are repaid.

The phenomenal growth in GSE lending in recent years makes it likely that the government would honor their implicit guarantee of GSE securities, rather than risk creating a crisis in the mortgage market. Because of this, many have argued that potential losses from these guarantees should be treated in the Budget as actual liabilities (see Chapter 6). While these GSEs have been very profitable in the last few years (Fannie Mae had a net income of $1.4 billion in 1991), Fannie Mae lost over $350 million between 1981 and 1985, and a large drop in housing prices could trigger much larger losses in the future.

Despite the government's exposure, these enterprises have been virtually unregulated. As in the case of commercial banks and S&Ls, the government's potential liabilities are reduced when the GSEs hold more capital. Higher capital also increases the GSEs' incentive to control risk. Recognizing the need for protection, in October 1992 Congress passed a bill that sets capital standards for the GSEs, and establishes an arms-length regulator who will be appointed by the President and located in the Department of Housing and Urban Development. These capital standards are structured similarly to those set by FDICIA for

banks and S&Ls; they are risk-based, and allow for "prompt closure" if capital falls below specified levels.

The level of the new capital standards for GSEs is significantly lower than that for banks and S&Ls for several reasons. First, mortgage loans have a lower default rate than the commercial loans that make up a significant fraction of bank portfolios. Second, GSE capital is based on market value, which is a much more reliable measure for gauging an institution's strength, as discussed above. Finally, because the GSEs "pass through" most mortgages rather than keeping them on their balance sheets, private investors, rather than the Federal Government, bear most of the interest rate risk.

Whether these new standards will adequately protect the taxpayer from GSE losses, however, is still open to question. Unlike the FDIC, which saves the premiums collected from banks in the Bank Insurance Fund, the guarantee fees collected by the GSEs can be distributed to shareholders. Also, although the GSE credit guarantees extend to mortgages passed through to investors, the new capital standards are based only on those mortgages that are kept in a GSE's portfolio, which represent less than one quarter of guaranteed mortgages. Thus the minimum capital level is a small fraction of the total value of guaranteed mortgages.

The best way to reduce the Government's liability from programs such as these, and still enhance market liquidity, is for the private sector to provide these services. The private sector successfully securitizes many types of loans, including credit card receivables, auto loans, some types of mortgages, and some types of commercial credit. An impediment to further private securitization of assets such as small business loans is the existing securities law, which requires private companies that securitize assets to comply with outmoded restrictions in the 1940 Investment Company Act. The Administration strongly supports a recent proposal by the Securities and Exchange Commission, which would exclude such companies from these restrictions, while still ensuring an adequate level of investor protection.

<u>Insurance Markets</u>

Insurance allows individuals to reduce their exposure to many types of risk by spreading losses across a large number of individuals. For instance, because an insurance company can accurately predict the total cost of houses that will burn down each year, homeowners can avoid what would be a catastrophic loss by paying an annual insurance premium equal to the average annual loss from fire.

Government insurance programs have been developed in part because some risks are difficult to predict and catastrophic in

size. The nature of the losses may make it difficult for the private market to develop actuarially sound premium rates or sufficient reserves to credibly insure such risks. Political considerations dictate the provision of other types of insurance.

As in the credit markets, the Government is increasingly taking a direct role in providing insurance. In fact, the Federal Government has become the Nation's largest underwriter of risk. Government insurance programs affect the economy in three main ways: they reduce and redistribute risk, they redistribute wealth, and they change the incentives of those receiving insurance.

When insurance is underpriced relative to its long-run cost, those who are protected receive a subsidy. Losses to Federal insurance programs have been substantial over the past decade (see Chapter 6). By far the largest losses have been from deposit insurance and pension guarantees. Although some of these losses were due to unforeseen and perhaps unavoidable events such as the droughts which struck the Nation's farms in 1983, 1988 and 1989, many of the losses can be attributed to improper assessments of risk on the part of the Federal Government.

The Federal Government often undermines the integrity of its insurance programs with disaster programs that provide similar benefits to insurance, but at little or no cost to the

individual. This too is a subsidy that diminishes incentives for individuals to avoid risky activities. As more individuals undertake the risky activities, the Government is put under increased pressure to provide assistance the next time there is a disaster. This phenomenon is typified by the experience of the Federal crop insurance program (see box 5-2).

Box 5-2. -- Federal Crop Insurance and Disaster Assistance

Crop insurance protects farmers from the possibility of low crop yields due to bad weather, pests, or disease. Since 1938, the Federal Government has offered crop insurance to farmers at prices that are subsidized by taxpayers. In the 1981-90 period, the Federal Crop Insurance Corporation paid out $2.5 billion more than it collected in premiums.

The Federal Crop Insurance Act of 1980 set out to establish crop insurance as the primary source of disaster risk management for farmers. Despite subsidized rates, many farmers do not participate in the program. In recent years, less than half of the eligible acreage was enrolled in Federal crop insurance.

Disaster assistance has undermined the effectiveness of the crop insurance program. Many farmers believe, based on their experience, that whenever there is a widespread natural disaster the Government will provide emergency disaster assistance to all affected farmers. In a recent survey, 34 percent of farmers who did not purchase crop insurance said that the belief that the government would bail them out in the event of a disaster was very important in their decision not to purchase insurance.

Ironically, low participation makes it all the more likely that Congress will enact disaster legislation when widespread disasters occur. For example, following Hurricane Andrew, $300 billion was allocated for affected farmers in Florida and Louisiana.

Insurance also reduces the incentives for people to make cost-effective choices. For example, offering subsidized insurance rates for flood protection can encourage people to build homes on flood plains. Deposit insurance makes it

unnecessary for depositors to monitor the activities of bank managers. Well-designed insurance programs set premium rates to encourage prudent behavior. In any case, the cost of misallocated resources should be part of any cost-benefit analysis of Government insurance programs.

Is there a further role for the private sector in providing insurance? As private financial markets continue to expand, private insurers may be able to handle liabilities that were once thought to be too large. Efficiency can also be improved by the innovative combination of private and public insurance. For instance, it has been suggested that private insurers could set premium rates to cover a portion of deposit insurance. The government's liability would be limited to losses exceeding the private coverage level.

One prerequisite for successful private insurance markets is a conducive legal environment. For instance, if dispute resolution becomes too costly, people will be less inclined to enter into contractual arrangements. A case in point is the market for auto insurance. Litigation costs have caused premium rates to increase sharply, creating a crisis in several States (see box 5-3).

Box 5-3. -- Auto Insurance

The cost of auto insurance in the 1980s rose at almost three times faster than the rate of inflation, and insurance premiums now exceed $1,000 per car in many areas. Poorer drivers who are unable to afford these high premiums often drive uninsured, which increases the costs to insured drivers further.

A root cause for these escalating insurance rates is the "pain and suffering" component of tort awards, which compensate victims for damages other than economic losses such as lost income and medical expenses. While accident victims do suffer psychological costs, the multimillion dollar settlements have become legendary. Nationwide, coverage for pain and suffering awards constitute 15 percent of insurance costs, while litigation costs (which are driven largely by the prospect of pain and suffering awards) account for another 10 percent.

Resistance by special interest groups has hampered auto insurance tort reform at the State level. To combat these costs, the Administration has proposed to Congress legislation that would offer consumers a choice between State tort coverage, and the "Personal Insurance Protection plan (PIP). Estimated cost savings from the new plan are between $20 billion and $30 billion annually.

Consumers electing PIP coverage would pay lower premiums for two reasons. First, under the PIP plan consumers waive their right to sue for pain and suffering. In return, they are insulated from similar claims by other motorists. The plan also specifies a first party reimbursement system, whereby drivers collect damages for economic losses from their own insurer rather than suing the other driver. This has the advantage of reducing litigation costs, and speeding up the payment process. Bad drivers are still penalized because their own insurance companies will raise their rates if they are found to be at fault.

SUMMARY

- The growth of financial services has benefitted consumers and businesses by lowering the cost of risk management and expanding investment opportunities.
- The increasing flexibility and international mobility of financial markets necessitates a regulatory framework that focusses on incentives, and avoids rigid command and control type rules.
- Although some progress has been made in reforming the regulation of depository institutions, impediments to efficient operation remain. Adoption of the

Administration's proposals would ensure a safe and competitive financial system.

OWNERSHIP AND PRICING OF THE NATION'S NATURAL RESOURCES

The previous sections of this chapter describe how government regulation influences economic decisions of private consumers and businesses. The government also influences these decisions in its role as owner and seller of public resources. Ironically, as the United States encourages privatization of government owned enterprise in Eastern Europe and the former Soviet Union, it continues to own a substantial share of the Nation's natural resources. The Federal Government owns about a third of the total land in the United States, including 29 percent of forest lands and 43 percent of rangeland. State and local governments and American Indian Nations own another 8 percent of U.S. lands. Over 20 percent of irrigated agricultural land in Western States uses water from Federal projects. Almost all roads and highways are government owned and operated.

The principles of regulatory reform -- allowing markets to work where possible, and harnessing the power of market incentives to accomplish regulatory objectives -- should also be applied to issues of government ownership and pricing of resources. This section will identify situations where government ownership of resources is unnecessary, and explore

some innovative ways of reducing the role of government in setting prices for natural resources.

In many cases, government ownership and pricing was established 50-100 years ago; today these policies are obsolete. Resources such as Federal rangelands and industrial timber stands have no special features warranting public stewardship. They are indistinguishable from adjacent privately owned lands. In a surprising number of cases, the U.S. Government sells and leases resources at rates substantially below market prices, often even below the direct cost of providing these resources. Low prices lead to overconsumption, distorted economic priorities, and often result in damage to the environment and larger budget deficits.

WHY DOES THE GOVERNMENT OWN AND MANAGE NATURAL RESOURCES?

Most goods and services in our economy are private property. They are traded in competitive markets which determine the price received by the owners, and the quantities consumed by the buyers. As noted in the introduction, competitive markets efficiently allocate resources to serve societal needs. Government ownership of land and other natural resources in the United States is, in large part, a residual effect of policies adopted in the last century to encourage settlement of sparsely populated western territory. Thus, in many cases, there is no economic reason for government ownership of these resources.

However, for some resources, there may be a market failure that does provide an underlying reason for government activity. There are two inter-related ways in which private markets for natural resources may fail to operate perfectly.

<u>First, many natural resources tend to be "public goods" -- they can be used or enjoyed by one person without affecting the use or enjoyment of others</u>. For example, suppose Farmer Jones builds a paved road from her farm into town. Jones's neighbors can use the road without detracting from its usefulness to her -- in this sense, the road is a public good. One can see from this example how the private market may fail to produce the right amount of a public good: all the neighboring farmers have an incentive to wait, hoping another farmer will incur the costs of building the road which all farmers can then use.

<u>Second, in many cases, natural resource use creates "external costs or benefits" which affect individuals who are not parties to the economic transaction</u>. For example, if a logger cuts down trees on a hillside, that may encourage soil erosion which imposes a cost on people living at the bottom of the hill. Those people suffer a cost which is not taken into account by the private market for trees.

Externalities are a natural consequence of the failure to establish "property rights" -- the legal assignment of ownership

-- for natural resources. For example, a river may run past many people's property. If someone upstream decides to use the river water -- by polluting it, for example, or diverting it for irrigation -- the downstream people are affected. The issue arises: who owns the river water? Should the downstream people pay the upstream user to use less? Or should the upstream user pay the downstream people for the upstream use? Here too, unless property rights have been assigned stating which parties "own" the rights to the water, private markets will not operate perfectly.

Sometimes, natural resources incorporate all of these aspects of market failure. An example is a "common pool" resource such as a communal grazing field. Everyone brings his or her cow to graze the field, but no single farmer owns the field; thus property rights to the field are not assigned. When there are relatively few cows, the field is a public good; use by one farmer does not affect its value to others. However, because every farmer has "open access" to the field (its use is free for the taking), farmers tend to bring more and more cows until the field becomes over-used, or congested. At this point use of the field by one farmer creates an external cost to other farmers; grass in the field may be killed from over grazing, and the field may become useless to all.

GOVERNMENT ACTION TO ESTABLISH MARKETS IN NATURAL RESOURCES

Establishment of private markets in natural resources often requires government action. The assignment and enforcement of property rights is quintessentially in the realm of government. During the 18th and 19th centuries, the U.S. government established property rights for lands on the western frontier, and then sold or gave away those rights to settlers.

One way for the government to address certain failures in markets for natural resources is to sanction legally valid private property rights, allowing the owner of the right to limit or sell access to that right. For example, the common grazing field could be given or sold into private hands, and access could be limited by use of a fence. Private property rights give the owner the incentive to stop overuse of the resource, and to conserve it for future use. The prospect of selling the resource creates an incentive to invest in increasing its value. Thus, private timber companies in the United States replant their lands to maintain forested areas over decades, while timber companies in some developing countries, who only hold short-term logging concessions on government-owned land, have no incentive to replant or otherwise sustain future forest resources.

But not all natural resources lend themselves to ordinary boundaries and fences. How can borders be defined for ocean fisheries, where fish move around and cannot be caged or labeled? Or for the use of the atmosphere as a storage space for waste

products? One way to address these kinds of resources is for the government to create a property right -- the right to use the resource -- and then to allow holders of the right to sell it like any other property.

For example, government-issued permits or licenses give people the right to fish, or to hunt. The 1990 Clean Air Act Amendments uses tradable permits to reduce pollution a lower cost. The law sets a cap on the quantity of sulfur dioxide pollution from electric utilities that will be allowed during a year, phasing down to about 9 million tons by the year 2000 -- about half of the level of emissions in 1990. The government issues permits to utility power plants adding up to the cap. But the cost of limiting emissions may be much higher at some facilities than at others. By allowing those permits to be traded, the law enables electric utilities to reallocate the permits so that plants which can reduce pollution least expensively will do so most. Making the permits tradeable will achieve the 9 million ton goal at a savings to the economy as a whole of an estimated 15-25 percent (or about $1 billion per year) compared to a phasedown without trading.

Box 5-4. -- Government Creates a Market for Fishing Rights.

There is no practical way for private markets to establish ownership rights of ocean fish stocks. Fish cannot be branded or kept in corrals; there is no way to determine if a certain fish caught is "my fish" or "your fish." Traditionally, fish have been free for the taking -- a common pool resource. Theory teaches that such underpricing should lead to overconsumption.

Indeed, in the halibut fisheries off Alaska, fishing fleets caught so many halibut and the number of these fish dropped so low that the total number dropped to levels threatening the survival of the stock. No single fishing boat had an incentive to restrain its harvest, since its impact on the overall fishery would be minimal and others would only increase their take.

The first attempted solution was to limit the length of the fishing season. But that only encouraged new capital investment in more numerous, larger, and faster boats with more effective (and expensive) fishing equipment. By the early 1990s the halibut fishing fleet was catching in a two day season the same number of fish that they had once caught in four months. Most of the halibut caught had to be frozen rather than marketed fresh, and halibut caught by mistake out of season had to be discarded.

In late 1992, the government tried a new approach: assigning each boat a permit -- in effect, a license to catch a certain number of fish. The total amount of permits issued will reflect scientific estimates of the number of fish that can be caught without endangering the survival of the species. Also, the permits will be transferable -- they can be bought and sold. By making the permits transferable, the permit system in effect creates a market where one did not exist previously. The most profitable and efficient boats will be able to operate at full capacity by buying permits from less profitable and efficient boats. This will ensure a fishing fleet that uses labor and equipment efficiently. Moreover, the transferable permits system establishes a market price for the opportunity to fish -- a price that better reflects the true social cost of using the common resource.

GOVERNMENT OWNERSHIP AND PRICING OF RESOURCES

Where privatizing the resource is not feasible, another solution to the problem of market failure is for the government itself to hold the resource on behalf of the public. Goods and services typically provided by the government include a militia to ensure the public defense, and a public fire department to protect neighborhoods from the spread of fires. The U.S. Government has purchased or created National Parks like the Grand Canyon and the Lincoln Memorial. These are public goods that can

be used and enjoyed by many people at the same time. As noted earlier, the private market may fail to provide a sufficient number of public goods as potential users wait for others to make the investment.

To an increasing extent, the government has focussed on establishing and protecting lands that have the character of public goods. For example, the Bush Administration successfully sued to protect the Florida Everglades and requested funding increases to purchase and restore wetlands nationwide. Under the America the Beautiful Initiative, funds for State land and water conservation were tripled, and 20 new national parks and 57 new national wildlife refuges were added or proposed.

Box 5-5. -- Forests as a Public Good.

Government ownership of natural resources is sometimes intended to help produce the "public goods" that private ownership would not. A prime example of this difference in objective can be found in the recent reformation of government stewardship of forests. Many private forests are harvested by logging companies through "clearcutting" -- harvesting every tree on a certain plot of land, and then replanting the land with seedlings. This can be the least costly way to gather timber for industrial uses. However, it does ruin the scenic value of that land.

Until 1992, the U.S. Forest Service and the Bureau of Land Management allowed clear cutting on Federal lands. In 1992 the Administration adopted a new "ecosystem approach" for managing these federally owned forests, under which clearcutting will be phased out as a standard timber harvest practice. Instead trees in Federal forests will be selectively harvested, in order to enhance the public goods of forest aesthetics and wildlife conservation. The Forest Service projects that the new policy will reduce clear cutting on Federal lands by as much as 70 percent, from 1988 while reducing total volume of logs cut by 10 percent or less. The policy will increase the costs of harvesting the logs, but will greatly improve provision of a public good -- the scenic beauty of the Nation's forests.

Government ownership of resources does not, of course, guarantee the best allocation and level of use of natural resources. These are critically influenced by the prices and terms on which the government allows use of the resources. The appropriate price is where marginal social cost equals marginal social benefit. The word "social" in this prescription means that costs and benefits should reflect the impact on all members of society -- that is, they should include external, as well as direct, costs and benefits. The word "marginal" in this prescription means that we should set the cost of the providing an additional incremental unit of the resource equal to the benefit of obtaining that additional unit.

<u>Chronic Underpricing</u>

Many government-owned resources are sold at prices that fail to incorporate full marginal social costs; sometimes the prices do not even cover out-of-pocket management expenses. Government policies adopted in the 19th century purposefully set prices low in order to spur settlement and development of the West. Most of these policies are still in effect today, many backed by powerful local constituencies who have come to rely on these low prices. In one extreme case, mining companies were able to buy land from the Federal Government for as little as $2.50/acre, and resell it for commercial development for as much as $11,000/acre. Efforts to amend the 1872 Mining Law that requires the government to sell

land at low prices, passed the House in 1992, but failed to pass the Senate.

Publicly funded freeways, highways and streets provide low-cost or free roadways that tend to be congested at peak use times in part because the cost of reducing congestion -- an externality -- is not charged to road users. Timber from Federal forests is typically sold at even less than what it costs the government to provide the timber (and without incorporating possible externalities such as environmental degradation of the forests). As mentioned in the telecommunications section above, access to the public good embodied in the electromagnetic broadcast spectrum is rationed without charge.

Box 5-6. -- Reform of California Water.

One highly publicized example of government underpricing of natural resources has been the pricing of California water. 40-year contracts signed in the 1940s and 50s guaranteed California farmers water supplies from Federal water projects at prices around $3 per acre-foot, even when the government's cost to supply that water is now near $30 per acre-foot. Compounding the perverse effect of these below-cost prices, cities and industry in need of water cannot obtain it from farmers because archaic legal restrictions block the development of water markets. Selling water was actively discouraged by public policy. Selling water to another user would only demonstrate that the farmer had no "need" for that water, resulting in a smaller allocation next year and discouraging any sales.

<u>In 1992, the Congress passed and the President signed pathbreaking legislation to adjust Federal water prices and establish water markets in California</u>. The 1992 Reclamation Act will let farmers sell their water to cities and industry at market prices without reducing future allocations, and will begin to nudge the prices charged by the government toward the out-of-pocket cost. Even if prices rise from $3 per acre-foot toward $30 per acre-foot, farmers are likely to earn significant profits in the new water market. In 1991, the California State Water Bank bought 820,000 acre-feet from farmers at $125 per acre-foot

and resold nearly 400,000 acre-feet to cities and industry at $175.

Drawbacks of Underpricing

Whether or not warranted in past eras, underpricing of Federal resources today can mean budgetary, economic, and environmental problems. The budgetary consequences are readily apparent: when the government sells resources below what it costs to provide those resources, the taxpayer is subsidizing those uses.

Second, underpricing directs resources to less economically valuable uses, and away from uses that would confer more economic value on society. In the California water example, cities and industry appear willing to pay substantially more than the value of the water to farmers; this is a powerful indication of the higher value uses to which the cities would put the water. Indeed, a good deal of the crops irrigated by low-priced Federal water are crops like alfalfa used for milk production which are in oversupply and are already being subsidized by Federal support programs. Letting farmers transfer water away from unneeded crops and toward high-value city uses could generate substantial economic gains.

Third, when underpricing of natural resources leads to overuse, this can cause harm to the environment. For example, if

the government underprices irrigation water, increased irrigation may lead to groundwater contamination.

Moving toward full social cost pricing of Federal resources in the United States could be an especially cost-effective means of generating environmental quality benefits as part of improved economic performance.

REFORMING PUBLIC RESOURCE POLICY

Given the chronic problems of government ownership of resources, what practical steps can be taken toward a better system? As mentioned above, in some cases, the government owned resources can be "privatized" -- given or sold to private individuals. Once in private hands, the resource would be priced in a market, restoring efficient allocation and reducing overconsumption. In addition, if government owned resources are sold, the revenue from these sales could be used to pursue other objectives, including deficit reduction.

Where use of a resource is associated with significant externalities, however, selling it to private buyers would not solve the market failure, since the prices charged by private owners would reflect private costs and benefits rather than social costs and benefits. It should be noted, however, that government ownership is not the only way to deal with externalities. For example, private timber cutting in the United

States is subject to liability, enforced by the legal tort system, for hillside erosion. Externalities can also be internalized through taxes, or other government action.

Where resources remain in government hands, prices at which these resources are traded ought to be real market prices, if not full social cost prices. This can be accomplished in any of three ways. First, where the appropriate price can be calculated, the government can set the selling price at that level. Second, where the market price is not known, the government can auction rights to use the resource, and let the auction define the market price. Third, the government could give away, or sell at low prices, the right to use the resource, but could allow that right to be transferable. In this last case, the market for transferable rights will set a market price for the rights, and (in the absence of externalities) will dictate an appropriate level of use.

Adjusting prices for the use of public resources is not a brand new idea; economists have been recommending it for decades. One difficulty in raising the prices that government charges for a resource is that people may have relied on the promise of low prices in making long-term investment plans. By setting resource prices below their market levels, the government creates a subsidy for those who use the resource. The subsidy will create excess demand for the resource. The government must

therefore set artificial limits on which groups or people can use the resource. In the California water example, farmers in the Central Valley received a subsidy -- in the form of artificially low water rates -- from the government. But only farmers who owned land in the Central Valley could receive those subsidies. The right to receive the subsidized water could not (until the law changed in 1992) be sold directly. However, that right could be sold <u>indirectly</u> by selling the land.

Thus the value of the subsidized water gets "capitalized" in to the market price for land. Recent purchasers of land paid a higher price in anticipation of receiving the subsidized water. When the government reduces the level of the subsidy by increasing the price it charges, the value of land is reduced; the government has taken from the land owners something of value. One advantage of the retaining the subsidized price, while making the right to that subsidized resource transferable, is that the benefits of the market allocation of resources are obtained without generating strong opposition among those who directly receive the subsidy.

SUMMARY

o Markets for natural resources are sometimes characterized by market imperfections: when the resource is a public good, or when use of the resource causes an external cost.

- o Often, the market imperfection can be eliminated by assignment of property rights. An innovative way to define these property rights is the creation of tradeable permits to use the resource.
- o In situations where the government retains ownership to a natural resource, pricing of the resource should reflect social costs and benefits.

RISKS TO HEALTH, SAFETY AND THE ENVIRONMENT

We live in a world of many risks: disease, crime, poor nutrition, accidents in automobiles and airplanes, accidents at home and in the workplace, and exposure to toxic substances. Facing risks is inevitable; the very fact that we are mortal simply means that we cannot always avoid every risk indefinitely. Yet despite these seemingly ubiquitous risks, in fact the total risk we face has steadily declined over time.

Over the long term, advances in knowledge, technology, and standard of living can reduce overall risk. In the short term, many risks can be reduced -- but at a cost. A more crash-worthy car may cost more. A truly zero-risk society would be impossible, and trying to reach such a goal would be prohibitively costly. Nor would it be desirable, because for some people some risks are worth taking -- such as playing sports for fun, traveling faster to get someplace important, or testing new technologies.

We deal with most risks through our own behavior, avoiding carelessness, purchasing insurance and opting to take risks where the benefits warrant. Some risks might affect us without our knowing, or rise to undesirable levels, were it not for government assessment and management of risks to human beings and to the environment. But is government doing the best job it can to examine and address risks of real importance?

RISK IN PERSPECTIVE

A common belief is that more technologically advanced society involves more risks. True, people in the 19th century faced no risk of dying in airplane crashes, and aboriginal villagers today probably face no risk of electrical house fires. But the "good old days" and the "simpler life" were also times of less prosperity for average people, lower nutritional intake, cruder medicine, and less safe food and water supplies.

<u>In fact the total level of risk is actually lower in modern industrial society than in earlier and less technological societies</u>. Life expectancy at birth, a measure of aggregate safety from all types of risk, has risen in the U.S from 47 years in 1900 to 75 years in 1990. Life expectancy in poorer countries is increasing, but apart from China and a few others, remains near 55 years at birth. Infant mortality rates in these low-

income countries are often as high as 10 percent of live births, 10 times higher than in the U.S.

To be sure, the risk to Americans of certain kinds of injury (such as an airplane crash) has increased over that time. And with new technology has come increasing scientific ability to detect ever smaller risks that formerly would not have caused concern. But in the main, the large risks we face have been reduced. Infant mortality fell 81 percent from 1940-1990, and the life expectancy of a person at age 65 increased 45 percent from 1900 to 1990. Except for lung cancer, most cancers have steadily declined. Most deadly infectious diseases have been all but eradicated in the U.S., although the AIDS crisis -- and associated increases in pneumonia, and other diseases -- is cause for national and international alarm.

Risks transmitted through environmental pollution have also declined. Between 1970 and 1989, air pollution declined significantly: lead emissions fell over 90 percent, particulates fell 61 percent, sulfur oxides 26 percent, carbon monoxide 40 percent, and volatile organic compounds 31 percent. Industrial discharges of key water pollutants declined over 90 percent between the mid-1970s and mid-1980s. Other indicators of ecological well-being (apart from impacts on human health), while more difficult to find and evaluate, also show progress; for example, forested area has been relatively stable since 1920,

total volume of wood in U.S. forests has grown 25 percent since 1952, and annual forest timber now exceeds harvests by 37 percent, even as population has more than doubled and total farm output has tripled since 1920.

The value of pollutant emissions reductions to human health is often difficult to quantify, but some estimates have been developed. Substantial evidence suggests that childhood exposure to lead, for example, causes brain damage and learning disabilities, reducing IQ and increasing expenses for remedial education and medical treatment. The phaseout of leaded gasoline over 1978-87 reduced airborne lead levels by 90 percent, in turn reducing average blood levels significantly.

These reductions in human and environmental risk have not been shared equally by all members of the population. Infant mortality is twice as high among blacks as whites. And despite the national decline in childhood blood lead levels, children in certain inner-city areas are much more likely to have high blood lead levels, particularly due to lead-based paint and leaded water pipes.

As the aggregate level of risk in society falls with higher incomes and technological advances, there are changes in the types of risks people face. Today two of the most important steps Americans can take to reduce their risk of death are using

auto safety restraints and quitting smoking. Seatbelt use increased from 10 percent to 50 percent among adults and 20 percent to 80 percent among children between 1980 and 1990, and rates of smoking for persons 18 years and over has decreased by 40 percent since 1965. Whereas cancer is the number two cause of death in the U.S., it is much less common in developing countries; there killers like food spoilage, diseases in drinking water, and infant mortality take their toll long before cancer can develop.

Table 5-1 shows a selection of risks to life faced by Americans in different activities and occupations. These can be compared to an overall annual risk of death faced by a random American of about 9 in 1000 (2.2 million deaths per year out of a total population of 250 million). If the 1000 random Americans all smoked 1 pack per day, about 3 more would die (the average 9-in-1000 rate already reflects that some deaths are due to smoking); if they all took 10 airplane trips, about 0.01 more would die. Cancer risks posed by environmental exposure to chemicals are much lower than other dangers: in total, pollution is thought to account for only 1-5 percent of all cancer deaths, occupational carcinogens about 2-8 percent, and food additives from -5 to 2 percent (i.e., they may actually protect against cancer); smoking and diet contribute much larger shares.

RISK IN THE MARKETPLACE

Table 5-1.--American Risks in Perspective

Added Risks of death per year, per 1000 population

Smoker, 1 pack/day	3.0
Worker in asbestos industry: (regulated in 1972, 1986)	3.0
Skydiver	2.0
	1.0
Professional firefighter	0.8
Police officer	0.22
If in auto accident	0.21
Due to appendectomy	0.20
Airplane crash (per 150 trips)	0.15
Childbirth	0.11
Hit by drunk driver	0.05
House fire	0.03
Child wearing flammable sleepwear (banned in 1973)	0.029
Airplane crash (per ten trips)	0.01
Exposure to hazardous waste site (regulated in 1988)	0.002
Airplane crash (per one trip)	0.001
Exposure to municipal solid waste site	<0.001
Being struck by lightning	0.0005

Source: Robert Mitchell, Clark University; Office of Management and Budget.

Every day, people make decisions about taking and avoiding risks. When people have good information about the risks they face and have the freedom to choose whether to take risks, the marketplace will reflect this information and people's attitudes about risk taking.

Social systems may develop to help people learn about risk, and to deal with situations where information and free choice are not available. Government regulation is one such social risk management system, but not the only one. Others include behavioral customs, insurance, the marketplace itself, and the tort system operated by the courts.

<u>The most prevalent social arrangement by which people deal with risk is by learning to modify their behavior to reduce risk</u>. People learn to drive defensively, look both ways before crossing the street, avoid dark alleys, lock their doors, and wash hands before eating. Many such social customs also help protect others in the community, such as covering one's mouth while coughing. Further, people purchase insurance against the chance of an adverse event, such as death, disability, fire, or theft.

Marketplace transactions also incorporate risk avoidance incentives. Safety is an element of product quality that consumers desire; all other things equal, consumers will choose to purchase goods offering greater safety. People buy child car

seats, fire extinguisher and reinforced locks. Today automobile makers are advertising airbags and braking systems as major selling points. In labor markets, if workers know that a given job entails a higher risk of injury, some workers will be less willing to take that job. More workers will offer their labor at safer jobs, and fewer at riskier jobs. This will raise the wage for the riskier job; employers will be forced to offer higher wages to attract workers to riskier jobs. This marketplace wage difference is an example of what is called a "risk premium." It acts as a kind of insurance paid to workers against the chance of suffering an injury. In addition, it encourages the employer to find ways to reduce risk. If the employer can reduce risk at less cost than the corresponding reduction in the wage risk premium, the employer will have an incentive to invest in greater worker safety.

Empirical evidence suggests that <u>workers in many occupations earn significant risk premiums</u>. The implicit value the average worker places on avoiding a fatal injury in the workplace appears to be about $3-7 million. But workers vary in how reluctant they are to take riskier jobs; workers who are willing to accept more risk (for whatever reason) tend to be found in higher-risk jobs. The implicit value of avoiding a fatal injury in very high risk jobs like coal mining, for example, was estimated to be $800,000.

<u>The fact that workers receive some risk premium for facing risk does not, of course, guarantee that these premiums are adequate</u>. When people do not have full information about risks, or when they cannot act freely on that information (such as when they cannot easily move to find a new job in a new town), they may earn risk premiums that under-insure them against risk. It might be, for example, that coal miners earn lower risk premiums because they are less mobile, not less averse to accepting risk. In situations where little information about a risk is available in the marketplace, as may be the case for latent diseases due to persistent low-level occupational exposure, wage risk premiums probably do not fully compensate for risks.

Market transactions based on exaggerated risk estimates may end up over-insuring against risk. For example, housing prices tend to be lower nearer to hazardous waste disposal sites, even though the EPA estimates that hazardous waste sites generally pose little risk.

[Section on THE ROLE OF GOVERNMENT IN REGULATING RISK to be added]

SUMMARY

- Facing risks is unavoidable, but reducing risk bears a cost and some risks can be acceptable in return for corresponding benefits.

o Human behavior, insurance and marketplace premiums address many risks.

CONCLUSION

Millions of complex economic decisions are made every day: How many soybeans should be produced, and how many ball bearings? How much labor and how much equipment should be used to produce any those products? How much should a person be paid for a given job? The United States economy relies on the competitive market system to answer these questions. Markets efficiently process all available information on the individual needs and wants of consumers, on the comparative scarcity of resources, and on the alternative methods of production. At times, however, markets that generate serious pollution problems, that have failures in the availability of information, or that are inevitably served by monopoly firms may not perform well. Government attempts to improve performance in these markets can create unintended consequences. Thus government regulation of markets should only be undertaken after a careful balancing of benefits and costs. This balancing should be done with the understanding that regulation itself is imperfect and that regulation can reduce the ability to respond to changing conditions, including the introduction of new technologies.

The President's Regulatory Reform Initiative established a government-wide review of regulatory policy to ensure that existing regulations were necessary to achieve their intended

goals and to ensure that regulations are implemented in a cost-effective manner. In particular, the power of market incentives are now being used to accomplish regulatory objectives, such as pollution control and more efficient energy markets. Reform of telecommunications regulation has also been an important goal of this Administration, benefitting consumers and businesses in the form of lower prices for communications services and service innovations. Similarly, in the Financial services sector regulatory reform has been directed at reducing the cost of risk management and expanding investment opportunities, while continuing to preserve investor protection and maintain market integrity. The government can also use market incentives to prevent overconsumption of natural resources by establishing property rights and by considering all social costs when pricing government-owned resources. In addressing risk regulation, it is important to recognize that government regulation is only one among many risk management systems, including behavioral customs, insurance, the marketplace itself, and the tort system.

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: HORNER, CONSTANCE, ASST. TO THE PRESIDENT
ODD: NONE
To: AG.
Control #: X92110916267
Date Received: 11-09-92 Date Due: NONE
Subject & Date
11-05-92 MEMO REGARDING HER PREVIOUS SUGGESTION THAT THE SECRETARIAL ADVISORY COMMISSION AND COMMITTEE MEMBERS BE PROVIDED A CERTIFICATE OF APPRECIATION OR SOME OFFICIAL RECORD OF SERVICE SUITABLE FOR FRAMING. ATTACHES A CERTIFICATE OF APPRECIATION DESIGNED BY THE DEPARTMENT OF TRANSPORTATION.

(NO RECORD OF PRIOR CORRESPONDENCE IN EXEC. SEC.)

	Referred To:	Date:		Referred To:	Date:
(1)	OAG;	11-09-92	(5)		
(2)			(6)		
(3)			(7)		
(4)			(8)		

W/IN:
PRTY: 1
OPR: MAU

INTERIM BY:
Sig. For: OAG

DATE:
Date Released:

5 November 92

Remarks
(1) TO OAG FOR ACTION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

November 5, 1992

MEMORANDUM FOR THE HONORABLE WILLIAM P. BARR
THE ATTORNEY GENERAL

FROM: CONSTANCE HORNER
ASSISTANT TO THE PRESIDENT
AND DIRECTOR OF PRESIDENTIAL PERSONNEL

Constance Horner

SUBJECT: Thank You Certificate

Previously, I suggested our secretarial advisory commission and committee members be provided a certificate of appreciation or some official record of service suitable for framing. If you have not yet done so, you might like to take a look at how the Department of Transportation has designed its certificate.

Attached is a copy.

U.S. Department of Transportation

DEPARTMENT OF TRANSPORTATION
UNITED STATES OF AMERICA

Office of the Secretary

Certificate of Appreciation

presented to

In recognition of your Significant Contribution
to the Bush Administration and the U.S. Department of Transportation
by serving on

Date

Secretary of Transportation

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: BARNETT, JANE E., OFFICE OF PUBLIC LIAISON, THE WHITE HOUSE
To: AG. ODD: NONE
Date Received: 08-19-92 Date Due: NONE Control #: X92081912448
Subject & Date
08-17-92 LETTER ATTACHING A COPY OF THE PRESIDENT'S REMARKS OF AUGUST 5, 1992, AT THE KNIGHTS OF COLUMBUS CONVENTION IN NEW YORK CITY, WHICH REINFORCED HIS COMMITMENT TO FAMILY VALUES, THE SANCTITY OF HUMAN LIFE, AND CHOICE IN EDUCATION.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	08-19-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1
	INTERIM BY:			DATE:		OPR:
	Sig. For: NONE			Date Released:		MAU

17 AUGUST 92

Remarks
INFO CC: DAG, ASG.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
8/20/92 JRH FYI
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

August 17, 1992

'92 AUG 19 P2:11

Dear Friend,

On August 5, 1992, the President addressed the Knights of Columbus Convention in New York City. In his remarks the President reinforced his commitment to **family values, the sanctity of human life**, and **choice in education.**

You may have heard the President's comments on this occasion:

> "...I am committed to fighting for ideas that will help repair this great nation's moral fiber."

> "...I am going to stand on my conscience and let my conscience be my guide when it comes to matters of life."

> "...when it comes to schools, I say let the parents choose -- public, private or religious."

The President also asked those gathered at the convention to:

> "look beneath the rhetoric, take a look at the ideas to determine who has the courage to stand up for changes that are morally right... I do believe America needs a leader willing to do what's right, not merely what is politically popular at the moment. And nowhere is it more clear in the decision a President must make every day to build real peace, to establish freedom and democracy."

The President needs your continued support to strengthen America's moral fiber. With your help we can make America's schools better and more accessible for our children and renew this great country's commitment to opportunity, responsibility, and religious freedom.

I have attached a copy of the President's remarks. If you have any questions or I can be of further assistance, please don't hesitate to contact me.

Sincerely,

Jane E. Barnett

Jane E. Barnett
Associate Director
Office of Public Liaison

THE WHITE HOUSE

Office of the Press Secretary
(New York, New York)

For Immediate Release August 5, 1992

REMARKS BY THE PRESIDENT TO KNIGHTS OF COLUMBUS ANNUAL SUPREME COUNCIL CONVENTION

Marriott Marquis Hotel
New York, New York

11:04 A.M. EDT

THE PRESIDENT: Thank you very, very much for that warm welcome. Thank you, ladies and gentlemen. (Applause.) Please be seated, and thank you all. May I salute Virgil Dechant, my friend of longstanding, and thank him for that most generous welcome here. Your Eminence, Cardinal O'Connor, it is a great pleasure, an honor, sir, to see you again. May I salute Cardinal Baum, Cardinal Gagnon, Bishop Daily; another old friend, Ambassador Tom Melady, who is doing a superb job for our country, representing us at the Vatican; clergy; and ladies and gentlemen.

And may I salute a man who used to be -- whose house made him a neighbor, Archbishop Cacciavillan, from Washington, the Nuncio there -- a good man, a good friend. Nice to see you. I'm glad you're here, sir. (Applause.)

And I have only one regret, Virgil. My timing was such that I did not hear the fitting and warm and wonderful ovation that you gave Mother Teresa yesterday. I understand it was really fantastic. (Applause.)

A report came across my desk the other day. It stated that most people in the Western world "felt exceedingly gloomy about the future." It said that "institutions were decaying, well-meaning people were growing cynical." These are exact quotes. And my first thought was that's what happens when people spend too much time watching the evening news. (Laughter and applause.)

I'm going to pay for that one tonight on that first 20 seconds. (Laughter.) Just kidding, Dan. (Laughter.)

No, but what I was reading was not a report about 1992 It was a history of public attitudes in Europe in 1492.

Public moods are prone to change, of course. We know that the gloom of 1492 was not to last for long. It was dispelled by the achievement of a man of humble birth, a man of vision, of courage, a man named Christopher Columbus.

Now, I know that every speaker comes before you and says they identify with Columbus. But I really mean it. Think about it. The guy was faced with questions at home about whether his global efforts were worth a darn. (Laughter.) Some critics wanted him to cut his voyage short. (Laughter.) He even faced the threat of mutiny. (Laughter.) And yet Columbus persevered and won -- not a bad analogy in my view. So I know this isn't political. (Laughter and applause.)

Now, I admit, Columbus also had to worry all the time about a lack of wind. (Laughter.) I don't have that problem with Congress. (Laughter.)

This year, as in Columbus's time, we hear a lot of talk about change. And sure, change is natural. But maybe a better word for the United States of America is renewal -- because the changes we need must be based on principles that never change.

I think my parents were like yours: They brought me up to understand that our fundamental moral standards were established by Almighty God. They taught me that if you have something for yourself, you should give half to a friend. They taught me to take the blame when things go wrong and share the credit when things go right. These ideas were supported by society.

Only recently -- His Eminence and I were talking about, not in this detail, but talking about this subject just a few minutes ago -- only recently in America have we seen the rise of legal theories and practices that reject our Judeo-Christian tradition. Cardinal O'Connor eloquently describes this as an "inversion of values." It's a deeply disturbing trend -- and it is diametrically opposed to my idea of the kind of change that's good for our great country.

Last month, just 12 blocks from here, there was another convention. (Laughter.) Now, I was very lucky, I did not -- and this is the honest truth -- I didn't hear any of the speeches. I was out fishing in Wyoming with Jim Baker. But I understand one of the speakers, known for his florid language, called me "the captain of the ship of state." I'm not sure he meant it as a compliment, but believe me, as a Navy man at a Knights of Columbus convention, the term suits me just fine. (Laughter and applause.)

I look at this office that you've entrusted with me as a lot of things, as more than managing the economy, more even than being Commander in Chief. I stake my claim to a simple belief: The President should set the moral tone for this nation.

And all around us, we see evidence that America's moral compass has gone awry. We seem to be moving away from the enduring idea of taking responsibility for our actions. Our city newspapers are filled with stories of drive-by shootings -- the taking of human life made more horrible by the awful anonymity through which it is accomplished. And recently I read a story of a kid from a good neighborhood charged in a gun store robbery. He told the police who caught him, "It's not like I'm a criminal, I'm on the Dean's List."

What is happening to America? As a nation, we face enormous challenges in education, crime, drugs. And yet each of them come back to the challenge of pointing our moral compass in the right direction.

And so I believe that a central issue of this election year should be, who do you trust to renew America's moral purpose? Who do you trust to fight for the ideas that will help rebuild our families and restore our fundamental values?

I believe -- and I've tried hard on this -- I believe I've earned your trust. And I am committed to fighting for ideas that help repair this great nation's moral fiber. (Applause.)

Welfare is one example. We all know that our welfare system has literally destroyed the concept of personal responsibility -- tearing families apart, with no incentives for people to work and save and improve.

I want something different. I have fought for a new welfare system that says yes to human potential. And today, as we speak, we are granting waivers to states so they can change welfare rules, encourage families not to fall apart, not to live apart, but to stick together. States are saying to recipients, either you get training or you don't get a check. Some states are even going so far

as to make a very tough call of saying to parents, if you can't afford another child, don't expect the taxpayer to pick up the added costs.

Now, these are tough choices -- (applause.) These are very tough choices, but they're all intended by the states to promote responsibility.

And the other side says they agree with the ideas. But if you look close, some argue that ultimately the only solution to welfare is a guaranteed government job for every recipient. I ask, is this any way to promote responsibility? If we guarantee everyone a government job, how can we reward initiative? Our reforms may sound tough, but not as tough as a lifetime of despondency and despair; a lifetime that strips every recipient of his or her dignity. Let's give people hope; let's give them opportunity.

Let's take a look at education. We know that to renew America, we literally must renew our schools. And I happen to believe that competition can be the greatest force for change in our schools in an entire century.

The other side says they agree -- almost. And the almost is what troubles me. Remember how old Henry Ford used to tell his customers they could have any color Model T that they wanted -- so long as it was black? (Laughter.) Well, the other side says their ideal is that parents could choose any school for their kids -- so long as it's run by the government.

If you'll excuse one blatantly political comment in which you'll have to concede has so far been a nonpartisan, almost, speech -- (laughter) -- my opponent won the teachers union endorsement by saying he's "unalterably opposed" -- those are his words -- "unalterably opposed" to letting Catholic parents and other private school parents have a fair share of education benefits.

And I believe that it's time to have the courage to fight for a different approach. Right now, if you want an alternative to public schools, you have to pay twice -- first for tuition and again through taxes. And a couple weeks ago I was in Philadelphia, hosted by Cardinal Bevilacqua. And a group of parents told me, "we want our kids to go to Catholic school, but we just can't afford it." So my solution is something called the G.I. Bill for Kids. Like the original G.I. Bill, my new approach offers scholarships or vouchers for students to take to any qualified school -- not only public schools, but Bible schools, yeshivas, Catholic parish schools. And when it comes to schools, I say let the parents choose -- public, private or religious. (Applause.)

What about promoting religion as a force for good in our society? I'm reminded of the story of a small boy who once began a prayer this way: "God bless Mother and Daddy, my brother, my sister. And, God," he said, "do take care of yourself. If anything happens to you, we're all sunk." (Laughter.) Maybe there's some doubts, but America is still the most religious nation on Earth. And I want to strengthen our faith further.

And, again, there are wide differences. Some think it's okay to hand out condoms in schools, but oppose amending our Constitution to allow our kids to put their hands together to say a prayer. I disagree. I call again on the Congress to pass a constitutional amendment restoring voluntary prayer to our classrooms. (Applause.)

The Senate opens its meeting with a prayer. The House of Representatives opens its meeting with a prayer. Nobody doubts that they both need it. (Laughter.) But let's allow the faith of our fathers back into those schools.

MORE

And there's a national tragedy: More than a half a million* abortions in this country every year. And we know -- we know there's got to be a better way -- human alternatives like adoptions and abstinence. Seven times I have ignored the polls and acted on what I believe is fundamental principle and vetoed, as Virgil very generously pointed out, abortion legislation. And I promise you again today, no matter the political price -- and they tell me in this year that it's enormous -- I am going to do what I think is right. I am going to stand on my conscience and let my conscience be my guide when it comes to matters of life. (Applause.)

Here's something else that bothers me. In some places, a 13-year-old-girl cannot get her ears pierced without parental permission -- without bringing her mother and father along. But some believe that the same girl should be able to get an abortion without parental consent. And I think most Americans believe this idea is crazy, and I'm going to fight to see that that doesn't happen. (Applause.)

So these issues are all -- they all come up in an election year. They'll be part of campaigns in the fall all across the country. And today I make the same appeal to you that I'll make to every voter. Look beneath the rhetoric, take a look at the ideas to determine who has the courage to stand up for changes that are morally right for America.

And I'm going to take my case to the American people. And if you're looking to restore America's moral fiber, why buy synthetic when you can get real cotton? (Laughter and applause.)

But I do believe America needs a leader willing to do what's right, not merely what is politically popular at the moment. And nowhere is it more clear in the decisions a President must make every day to build real peace, to establish freedom and democracy -- not the mere absence of war.

Saint Ignatius said, "Work as though all depended upon yourself, and pray as though all depended on God." The practice of that motto conquered communism. Ceaseless prayer and tireless work halted the Cold War and spared us from the catastrophe of a third world war. Believers behind the Iron Curtain defied persecution; believers in the West defied indifference.

Over four decades, our servicemen trained -- our taxpayers paid $4 trillion -- to keep our defenses strong. And as a consequence, the Iron Curtain is no more and our kids no longer go to bed at night worrying about that dreadful specter of nuclear war.

But while the Soviet bear is no more, there are still plenty of wolves in the woods. And when we faced our first big challenge after the Cold War, we didn't shrink. We stood up to Saddam's aggression and expelled him from Kuwait. We protected the people of Israel and Saudi Arabia. And now we've brought age-old adversaries to the peace table for the first time. His Holiness, Pope John Paul, has spent many days and nights at work and in prayer for peace in the Middle East. As long as I am President, I assure you I will do everything I can to bring about that peace that so many pray for. (Applause.)

And so, in conclusion, let me say this: This is the year of change, change, change. The election will all be about change because change really is the natural condition of our land. This isn't something new. I believe that now we've changed the world, we are poised and ready to change America, to make America

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* million and a half

MORE

even better. But we must keep something important in mind. Now that our moral values are victorious around the globe -- we cannot and we will not abandon them at home.

We didn't stand together to see courageous moral values rise in Russia, only to be ignored here at home. We did not sacrifice so that personal responsibility could triumph in totalitarian regimes, only to become passe here in this great nation.

It's time to get back to some basic American values. And so I am going to defend the principles for which you stand so firm. We will keep our sights on what's good in America. We will keep our focus on the potential in our families and, most of all, in our young people, in our kids. We'll keep a reliable compass. We'll put our ship of state in finest sailing trim. And as this nation has so many times before, we will sail on to shining new horizons.

Thank you. May God bless you and our beloved country, the United States of America. Thank you very much. (Applause.)

END 11:25 A.M. EDT

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRES./DOMESTIC POLICY
To: MOORE, HENSON (CC: AG.) ODD: NONE
Date Received: 08-18-92 Date Due: NONE Control #: X92081812359
Subject & Date
08-13-92 MEMO ADVISING THAT DAG/TERWILLIGER MENTIONED THAT THE 10TH ANNIVERSARY OF THE ORGANIZED CRIME AND DRUG ENFORCEMENT TASK FORCES IS BEING HELD IN SAN ANTONIO, TX, IN THE AUGUST 31-SEPTEMBER 2, 1992, PERIOD. INDICATES THAT THIS MIGHT BE A GOOD FORUM FOR LAUNCHING NEW CRIME INITIATIVES.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	08-18-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1P

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: MAU

13 AUGUST 92

Remarks
INFO CC: DAG.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
8/18/92 RW FYI
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL
CROSS REFERENCES:
1. TASK FORCES/OCDEFT

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

A G - B. Barr

'92 AUG 18 A11:18

EXECUTIVE [illegible]

THE WHITE HOUSE
WASHINGTON

DATE: Aug. 13, 1992

TO: Henson Moore

FROM. CLAYTON YEUTTER
Counsellor to the President for
Domestic Policy

Henson, George Terwilliger mentioned this morning that the 10th anniversary of the Organized Crime & Drug Enforcement Task Forces is being held in San Antonio in the Aug. 31-Sep. 2 period. That might be a good forum for launching our new crime initiatives.

Cy

cc S. Skinner; Roger Porter

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRES./DOMESTIC POLICY
To: SKINNER, SAM (CC: AG.)
ODD: NONE
Date Received: 08-18-92 Date Due: NONE Control #: X92081812336
Subject & Date
08-13-92 MEMO ENCLOSING A COPY OF A MEMO HE RECEIVED FROM CHARLES E.M. KOLB DATED AUGUST 11, 1992, REGARDING RECESS APPOINTMENTS.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	08-18-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1P

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: MAU

13 AUGUST 92

Remarks
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

August 11, 1992

MEMORANDUM FOR CLAYTON YEUTTER

FROM: CHARLES E.M. KOLB CEMK

SUBJECT: Recess Appointments

A thought for the future. Given the positively sordid conduct of the American Bar Association this week at its annual convention, why should we ever again submit judicial nominees to the ABA for review?

We don't screen Assistant Education Secretaries with the National Education Association, so why give the ABA a first strike? If the ABA wants to express its opinion on a given candidate's qualifications, then they should be able to testify at the confirmation hearing along with other interested individuals or groups.

Also, why not suggest that the President give recess appointments to all judicial and PAS nominations that have been pending for, say, sixty working days? If we are to launch a campaign against the Congress -- highlighting, of course, its inability to complete its work and, thereby, its keeping the Executive Branch from meeting its responsibilities -- then a series of recess appointments would constitute presidential action signalling that George Bush is fed up.

An argument against recess appointments is that subsequent permanent appointments would be jeopardized. This is fallacious for at least two reasons:

- If we lose on November 3, so what? The judicial appointments will end in January 1994; the PAS sooner.
- If we win on November 3, then these nominees will have to undergo Senate confirmation at a future date. Their fitness is in no way compromised by such executive action.

This morning I was speaking with Frank Keating, HUD's General Counsel. As you may know, Frank's still awaiting confirmation to the Tenth Circuit; his papers went to the Senate <u>last November</u>! Frank has bipartisan support (Boren and Nickles) and has been a lifelong NAACP member. Yet there has been no action to confirm since an earlier hearing. I asked whether he'd accept a recess appointment. Frank had no reservations whatsoever. Nor should we.

A. G. Barr

'92 AUG 18 AM 11:18

EXECUTIVE

THE WHITE HOUSE
WASHINGTON

DATE: ~~Aug. 13, 199~~2

TO: S. Skinner

FROM: **CLAYTON YEUTTER**
Counsellor to the President for
Domestic Policy

Per our discussion of recess appointments at breakfast the other morning, you might enjoy and appreciate this memo from Charlie Kolb.

CY

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: WALDEN, GREGORY S., THE WHITE HOUSE
To: OLYMPIC DINNER INVITEES (AG.) ODD: NONE
Date Received: 08-18-92 Date Due: NONE Control #: X92081812348
Subject & Date
08-10-92 MEMO ADVISING THAT THE AG MAY ACCEPT THE INVITATION OF THE U.S. OLYMPIC COMMITTEE TO ATTEND THE ANNUAL OLYMPIC DINNER TO BE HELD ON SEPTEMBER 30, 1992, IN WASHINGTON, DC, UNDER THE "WIDELY ATTENDED GATHERING" EXCEPTION TO GIFT RESTRICTIONS.
.
SEE EXEC. SEC. 92081212105 CONTROL SHEET ATTACHED.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	08-18-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1S

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

10 AUGUST 92

Remarks
INFO CC: OAG (PATTERSON, SCHATZ).
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

'92 AUG 18 AM 11:17

August 10, 1992

EXECUTIVE SECRETARIAT

MEMORANDUM FOR OLYMPIC DINNER INVITEES

FROM: GSW GREGORY S. WALDEN

SUBJECT: Attendance at The Annual Olympic Dinner

I have considered whether you may accept the invitation of the United States Olympic Committee to attend The Annual Olympic Dinner to be held in Washington on September 30, 1992.

Whether or not the United States Olympic Committee (USOC) is considered a "prohibited source" under the standards of conduct for the Executive Office of the President, and even though these invitations were most likely extended to you because of your official position, you may accept the dinner invitation under the "widely attended gathering" exception to gift restrictions. This dinner is clearly of interest to the White House, confirmed by the President's serving as Honorary President of the USOC, and I find that neither the timing nor the reason for the event would create an appearance of impropriety in any White House official's attendance.[1]

Therefore, you may accept the invitation.

You need not report this dinner on your next financial disclosure report because the dinner constitutes "food and beverages not consumed with a gift of overnight lodging."

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[1]Steve Bull, USOC's Director of Government Relations, has confirmed that "[s]eating will be totally arbitrary, with Executive Branch officials distributed evenly throughout the hall." Therefore, no one will be offered a seat next to or at the table of a particular Federal official.

DOJ EXECUTIVE SECRETARIAT CROSS-REFERENCE RECORD

CONTROL NUMBER: 92080611794

BARNETT, JANE E, White House Public Liaison Office

(Pres. Statement from the Signing Ceremony
for S. 1150 Higher Education Bill)

THE ENTIRE DOCUMENT PACKET FOR THE CONTROLLED CORRESPONDENCE INDICATED BY THE ABOVE EX.SEC. CONTROL NUMBER HAS BEEN FILED IN THE FOLLOWING PRIMARY FILE LOCATION WITHIN THE SUBJECT FILES OF THE ATTORNEY GENERAL.

PRIMARY FILE: LEGISLATION/S. 1150

30 JULY 92

WHITE HOUSE CORRESPONDENCE/GENERAL 30 JULY 92

THOMAS E JURNEY,

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IMM CONDOLENCES , CONGRESSIONAL/COORESPONDENCE

AUGUST 9,]99 []1992]1992

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DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: BARNETT, JANE E., OFFICE OF PUBLIC LIAISON, WHITE HOUSE
To: KEY CONTACT (AG.)
ODD: NONE
Date Received: 08-04-92 Date Due: NONE Control #: X92080411650
Subject & Date
07-30-92 LETTER ENCLOSING EXCERPTS FROM THE PRESIDENT'S QUESTION AND ANSWER SESSION TO A FORUM ON EDUCATIONAL CHOICE HELD ON JULY 21, 1992, AT ARCHBISHOP RYAN HIGH SCHOOL IN PHILADELPHIA, PA, ALONG WITH A WHITE HOUSE FACT SHEET THAT DESCRIBES THE GI BILLS FOR CHILDREN IN GREATER DETAIL.
.
SEE EXEC. SEC. 92071310430 - CONTROL SHEET ATTACHED.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	08-04-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: MAU

30 July 92

Remarks
INFO CC: DAG, ASG, OLA.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
8/4/92 JRH FYI
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL
L920804 2674

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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THE WHITE HOUSE

WASHINGTON

'92 AUG -4 AM 10:41

EXECUTIVE CORRESPONDENCE

July 30, 1992

Dear Key Contact,

President Bush is "taking his case to the American people" regarding revolutionary change in America's schools. The President has declared educational choice "the boldest education program that's been conceived for our country" and is firmly committed to presenting it as a cornerstone of the AMERICA 2000 education revolution.

President Bush visited with the Catholic community of Philadelphia on July 21, 1992. During the President's trip to Archbishop Ryan High School, he met with Cardinal Bevilacqua and Catholic families. Following this meeting the President participated in a question and answer session on educational choice to an audience of 600 students, parents, teachers, and educators. The President utilized this forum to emphasize his commitment to school choice, highlight the benefits of the GI Bills for Children, and reinforce the necessity of family values in the lives of America's students.

As you may know, on June 25, 1992, President Bush announced his GI Bills for Children as integral steps toward educational choice for all American families. If approved, this initiative would appropriate $500 million federal dollars in Fiscal Year 1993, and additional amounts in later years, to help states and communities provide $1,000 scholarships to children of middle- and low-income families. Parents could spend this money on their child's education at any lawfully operating school -- public, private, or religious.

We will need your continued support and leadership to make educational choice for all American families a reality. Educational choice, beginning with the President's GI Bills for Children, will enhance and strengthen the public schools, as well as provide choice for the families that want to send their children to private, public or religious schools. We need your assistance now more than ever in this AMERICA 2000 education revolution.

I have enclosed excerpts from the President's question and answer session as well as a White House fact sheet that describes the GI Bills for Children in greater detail. If you have any questions or I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Jane E. Barnett

Jane E. Barnett
Associate Director
Office of Public Liaison

THE WHITE HOUSE

Office of the Press Secretary
(Philadelphia, Pennsylvania)

For Immediate Release July 21, 1992

REMARKS BY THE PRESIDENT
TO FORUM ON EDUCATIONAL CHOICE

Archbishop Ryan High School
Philadelphia, Pennsylvania

12:36 P.M. EDT

THE PRESIDENT: Before taking your questions let me just make a few brief comments. The first, of course, is to say how very, very pleased I am to be here; and secondly, to thank Maria for that extraordinarily personal and generous and kind welcome and introduction. To say to Kelly Geiger, I'm glad he's not running for president this year. (Laughter.) Articulate guy that he is. But I was most moved, as I told His Eminence, by Kelly's presentation and by Maria's introduction.

I want to say how pleased I was to be here for the lovely grace, most appropriately said before our meeting here today. May I salute His Eminence Cardinal Bevilacqua and salute him for his leadership in working for the broad principle that kids ought to be able to choose the school that they attend. It is a sound principle and I support it strongly. (Applause.)

Our G.I. Bill for children is not conceived out of denigration for the public school system. Indeed, the way our proposal works, it would enhance and strengthen the public schools, as well as providing choice for the families that want to send their kids to parochial schools, to private schools, be they religious or not.

So we've got a good proposal. And I support it all the way and I will fight for it. And I believe that it will make all schools better, not just those that are selected by the people who participate in this marvelous program.

I also want to salute Lamar Alexander, the former Governor of the state of Tennessee, an outstanding Secretary of Education who is not afraid to take on the educational establishment, because he knows and I know that in the program we have, a program called America 2000, we are on the right track in terms of offering the best possible education to every kid in this country. We literally want to revolutionize education and bring the control and participation as close as possible to the families, as close as possible to the local communities.

And that's the rationale behind what I think is the best and boldest education program that's been ever conceived for our country. And again, I want to take that case to the American people.

We've made some progress in education, but we've got to do more. We have six national education goals that we've set out, and it ranges all the way from Head Start, support for that, all the way up to the fact that no one's too old to learn. Lamar talked me into demonstrating that no one is too old to learn and I've learned now how to turn on my computer and I am making dramatic headway. (Laughter.) I refuse to take on any of these kids, however, in computer science. But we've got a good program and it fits nicely into the values that I believe the Church here epitomizes.

THE PRESIDENT: Well, we're going to continue to support it, Officer. And I'll tell you, I am not pessimistic about the economic future. One of the things we must do -- and set aside for a minute this question of educational choice -- one of the things we must do is succeed in our overall approach to quality education. The way we are going to have -- guarantee the future for your kids and those that follow is going to be to have an economic environment, an economic environment in this country where people can get jobs.

We've been through this long, slow recession. We're growing a little bit now as a country. In my view, we are poised for a good recovery. Our interest rates are down, inflation is down, and all of this. But to succeed, to really compete in the world, we are going to have to succeed in achieving by the end of this decade our six educational goals. And I think we can do it. And if we do, we're going to be able to compete. We'll have better jobs and we're going to be able to sell more abroad.

Exports have saved us, incidentally, in this slow, anemic time -- a time of anemic economic growth. So as I look at how to answer the questions to your kids coming along, one of them has got to be success in achieving these six national educational goals. And then, of course, a part of that is school choice; a part of that is encouraging every way we can excellence in education.

We're doing -- we've got good programs to increase the math and science. I was only half kidding when I mentioned the computer. We are not going to succeed and compete abroad if we don't do better in math and science. And Lamar has pushed through some very strong support for those who are studying and teaching in math and science. So we can make it, but we've got to go along and succeed in our goals here.

Yes, sir.

Q Hi, Mr. President. I hate to sound like Barbara Walters, but I need to know where is the money coming from? Is it going to be taken out of taxes? Because we're so much in debt and you're posing this bill -- I'm just curious as to where the money is coming from.

THE PRESIDENT: The money is coming from a regular appropriation if we can get it passed. It will start as a $500 million demonstration program, and it's figured into our budget so it will not increase the deficit. And it will come through the regular appropriations process in the Congress -- if we can get the United States Congress to think new thoughts.

The problem is many that control the educational establishment in Washington are in the grips of a very powerful union, the NEA. And if you'll excuse me one political comment, it seems to be an arm of the opposition party. They are not thinking anew. They are fighting us on school choice. And many of the congressmen just don't want to stand up against that.

But it doesn't matter what party you're in, we've got to get the programs through. And then, if it gets passed, it is already covered under our budget so it won't add to the deficit. And that's the way it will come -- regular appropriations.

Q Thank you for coming, Mr. President. I'm the mother of a 16-year-old with Down's syndrome, and I'm also a physician who's been practicing in this area, obstetrics and gynecology, for 30 years. And I know as well as you know that no matter what we do in the area of genetics, no matter how many genes we transplant, no matter how much reproductive freedom we give women, we're always going to be faced with handicapping conditions.

And my first question of two is, what are we doing about the status of 94142, are we putting any money into special ed? Because the earlier we educate the handicapped kids, just like normal kids -- if we get to them before age six or seven, we have a good chance of making them as independent as they can be, and we have less of a problem at the other end of life's spectrum if we educate them early.

THE PRESIDENT: Presidents are never supposed to say "I don't know." That's a very bad form. And Presidents are supposed to know absolutely everything and not be quite as omnipotent as the Cardinal, but nevertheless -- (laughter) -- know a lot. I would ask Lamar to address the question of what kind of funding we're doing. But I will say this -- and one of the great -- the most forward-looking pieces of civil rights legislation that has been passed in history was the Americans for Disabilities Act. And I take great pride in being the steward of that legislation.

And in fairness, I've got to say it wasn't Republican, it wasn't just Democrat. It was a case where we could get together with the Congress and do something that was right for people so that people that were born with disabilities would not be shoved off to the side, but find a way to get instrumentally involved in the system itself to the best of their abilities.

Lamar, do you know the answer on funding, what we're doing on special ed? Maybe you could grab the mike -- and if you don't, pass it over to the Cardinal. (Laughter.)

SECRETARY ALEXANDER: Two quick points, Mr. President -- I'll be glad to sit down with the lady afterwards and talk a little more. One is the funding for special education has been increased, but not as much as it takes to fully fund the law that you've mentioned. The President's top budget priority, more new money into education this year than any other department in the federal budget.

Second, there have been big increases in Head Start over the last four years -- 127 percent while the federal budget only went up 25 percent. And that helps with the early intervention for young children.

THE PRESIDENT: In fact, we have fully funded, I think it's every four-year-old, isn't it -- eligible four-year-old.

Back again? Shoot, Doctor.

vote, I'm going to sit on the sidelines, nobody can get anything done. You look around the world today and the United States is still the envy of the entire world. And for us to give up on our system because of a frustration, we ought not to do that. We have got to do exactly what you've said.

And I am not going to give up on fighting for this. And the election offers us a great opportunity -- I'm not just talking about me -- as you said, I'm talking about Congress where we must change things. I won't give you my political speech about one institution -- one party controlling the United States Congress since 1956. And they don't know how to run a post office and they don't know how to run a bank. And we need to change that while we're at it. (Applause.)

Q Hi, Mr. President. Last year, my eighth grade year, I had to decide what high school I was to attend. It was decided for me that I was to attend a public school because how much Catholic high school costs. I received a partial scholarship, a Connolly Foundation Scholarship. If it wasn't for that I would be attending a public school which I didn't want to do.

I have a brother and a sister who -- my sister's going into seventh grade. She's going to have to attend a public school and so is my brother. They don't want to do that. That's why this is so important to us because the financial cost, it's too expensive for them to attend. I was fortunate enough to be able to do this because of a scholarship, but they're not going to be able to go to the high school of their choice because of the cost.

THE PRESIDENT: Was there a question or are you just explaining -- if there was a question I am embarrassed to say I couldn't hear it. But I did get your statement. Thank you.

Q I would like to know what would happen if all the Catholic and private schools had to close down and we all had to go to public schools? (Applause.) Wouldn't that be a strain on the budget? (Laughter.)

THE PRESIDENT: You know how to complicate my life; don't do that. You ask a good question. But the debate -- you know, I love the pride that obviously you feel in the education you're getting. And I love the family feeling around here about the importance of providing this kind of education with family and faith and all of that as a centerpiece. I mean that's good.

As President I've got to look at that and then I've got to look beyond it. What can we do to strengthen all the education in this country? They aren't going to crater, these schools are not going to crater, the private schools are not going to crater and fall down. You've got too much going for you in terms of excellence. And, yes, it's a strain on the Catholic Church.

I was told by a leading businessman in Philadelphia coming out here that businesspeople in Philadelphia put up something like $75 million, I believe was the fee, not Catholic -- others put it up there to support the parochial schools because they believe -- the private schools and parochial schools -- because they believed in offering the best possible quality education.

So don't worry that the whole system is going to collapse. But as President -- and I'm sure everyone here would agree with this -- it isn't a question of just making these schools better and then denying the great public school system in this country. We want to make that better. We want to bring change to those marvelous institutions that can do a better job. And we think this whole concept of choice will improve everybody else as well as helping the families.

and say do you want to be tougher on this crime? Do you want to have, yes, rehabilitation and all of that? Do you want to strengthen the families that are threatened when some mother's coming home at night on a subway or a bus and the kids waiting there, doesn't even know if she's going to make it back there? And the answer is, we do have to be hard-nosed and tough against the criminal element and then support those and try to rehabilitate some of these kids that are caught up in this drug fight.

We've got a good program called Weed and Seed that I went over with the police chief here before he moved out to California. It weeds out of the neighborhoods the criminal elements and then seeds them with jobs and hope and opportunity and homeownership and a lot of other things.

So the program -- no federal program is going to solve it. What's going to solve it is what you feel surrounded by family, love and faith in this room. And I really mean this. Don't take my word for it, talk to these mayors. How do we restructure and strengthen the American family?

But I will do my level best to take to the American people the case that your comments brought to my mind. Strengthen the family and the neighborhoods by protection; do it by education; do it by changing the welfare system to have respect for learning and work and not just dependency. And then do it in a Christian way, as I would say here in a Christian setting, but do it in a way of faith because you've got to recognize that a lot of people have had it very, very rough.

And I will end with this. And I hope you understand. Barbara Bush says what happens in your home is more important -- in your house is more important than what's in the White House. In a way she's right because what she's talking about there is the need to hold these families together, lift these kids up and give them the love. Every kid has to have somebody that knows his name. And sometimes in this hopelessness and despair that doesn't take place.

So I really want to help you try to get to the bottom of what you're talking about here. It is an odd year. It has not been particularly pleasant for me or my family, but I'm a fighter and I'm going to take this case to the American people.

And may God bless all of you. Thank you very, very much. (Applause.)

END 1:15 P.M. EDT

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release June 25, 1992

Federal Grants for State and Local 'GI Bills' for Children

FACT SHEET

The President today transmitted to the Congress the "Federal Grants for State and Local 'GI Bills' for Children." This bill would authorize $500 million in fiscal year 1993, and additional amounts in later years, to help states and communities provide $1,000 scholarships to children of middle- and low-income families. Each family may spend these scholarships at any lawfully operating school -- public, private, or religious.

The original GI Bill, enacted 48 years ago this week, gave scholarships to veterans to use at any college of their choice, public or private. Veterans used this consumer power to help create the world's best system of colleges and universities.

Today, there is little consumer power for the parents of most elementary and secondary school students. Choosing a school is mainly an option for families wealthy enough to move to a different public school area or for those who can afford a private or religious school. Partly because of this lack of choice and an absence of the competition among schools that choice would create, many children have to attend elementary and secondary schools that do not provide an adequate education. This legislation is designed to give middle- and low-income parents greater consumer power.

The proposed legislation includes the following elements:

Authorized Program

- The Department of Education would make competitive 4-year grants to states and localities for scholarships to children from middle- and low-income families.
- Scholarships would be in the amount of $1,000, plus any additional support available from non-Federal sources.
- Families would use these scholarships to send their children to any lawfully operating school -- public, private, or religious.

- They could also use up to $500 of the scholarship to obtain supplementary academic services for their children.

Eligibility

- Any state or locality can apply for funds sufficient to give each child of a middle- or low-income family a $1,000 annual scholarship. In order to qualify, the governmental unit would have to:

  - Take significant steps to provide a choice of schools to families with school children in the area;

  - Permit families to spend the $1,000 Federal scholarships at a wide variety of public and private schools; and

  - Allow all lawfully operating schools in the area -- public, private, and religious -- to participate if they so choose.

Project Selection

The Secretary of Education would select grantees on the basis of:

- The number and variety of choices made available to families of eligible children;

- The extent to which the applicant has provided educational choices to all children, including children who are not eligible for scholarships;

- The proportion of children who will participate who are from low-income families; and

- The applicant's financial support (including private support) for the project.

Eligible Students

The maximum family income for eligible children would be determined by the grantee, but it could not exceed the higher of the state or national median income, adjusted for family size. (For example, in 1989 the national medium family income for a family of four was roughly $40,000.)

Student Selection

- All eligible children in the project area would receive $1,000 scholarships, as long as sufficient funds are available. If all eligible children cannot participate, the grantee would provide scholarships to those with the lowest family income.

- Students would continue to receive scholarships over the 4-year life of a project unless they leave school, move out of the area, or no longer meet the income criteria.

Anti-discrimination Provisions

The proposed legislation provides aid to families, not institutions. However, as a condition of participating in this program, a school must comply with the federal anti-discrimination provisions of: section 601 of title VI of the Civil Rights Act of 1964 (race), section 901 of title IX of the Education Amendments of 1972 (gender), and section 504 of the Rehabilitation Act of 1973 (disability).

Supplementary Academic Services

Up to $500 of each scholarship may be used for other academic programs for children before and after school, on weekends, or during school vacations.

Amount of Grant

The Secretary would determine the amount of each grant on the basis of the availability of funds, the number and quality of applications, and other appropriate information.

National Evaluation

The Department of Education would conduct a comprehensive evaluation of these demonstration projects. The evaluation would assess the impact of the program in such areas as educational achievement and parents' involvement in, and satisfaction with, their children's education.

Funding

$500 million is authorized in FY 1993, sufficient to fund scholarships for 500,000 students. The proposed legislation authorizes "such sums as may be necessary" through FY 2000.

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRESIDENT, WHITE HOUSE
To: AG.
ODD: NONE
Date Received: 07-29-92 Date Due: NONE Control #: X92072911404
Subject & Date
07-24-92 MEMO THANKING THE AG AND HIS STAFF FOR THE
10-MINUTE DRAFT PRESIDENTIAL SPEECH ON CRIME, THE SHORTER
OUTLINE AND THE COMPILATION OF QUESTIONS AND ANSWERS.
ADVISES THAT IT IS A FINE PIECE OF WORK AND PRESIDENT BUSH
WILL BE VERY GRATEFUL FOR IT.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	07-29-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1S

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

24 July 92

Remarks
INFO CC: OPC.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRESIDENT, WHITE HOUSE
To: RAMBERG, CHRISTINE (CC: AG.) ODD: NONE
Date Received: 07-16-92 Date Due: NONE Control #: X92072010837
Subject & Date
07-10-92 LETTER (COPY) IN RESPONSE TO CORRESPONDENCE FROM CHRISTINE HUGH RAMBERG AND WILLIAM WEEKS OF THE CANAL AREA PROPERTY AND BUSINESS OWNERS ASSOCIATION IN SAN RAFAEL, CALIFORNIA, WHO HAVE EXPRESSED THEIR CONCERNS ABOUT THE IMPACT OF ILLEGAL IMMIGRATION ON THE AVAILABILITY OF SOCIAL SERVICES, PUBLIC EDUCATION AND JOBS IN MARIN COUNTY, CA, W/ATTACHMENT.

	Referred To:	Date:		Referred To:	Date:
(1)	OAG;	07-20-92	(5)		
(2)			(6)		
(3)			(7)		
(4)			(8)		

W/IN:
PRTY: 1
OPR: EHZ

INTERIM BY:
Sig. For: NONE
DATE:
Date Released:

10 July 92

Remarks
INFO CC: DAG, INS.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
INFO CY TO GJT 7/21/92
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL
I920720 942

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

Attorney General Barr

THE WHITE HOUSE

WASHINGTON

July 10, 1992

'92 JUL 16 P3:37

Dear Ms. Ramberg:

Thank you for your recent letter expressing concerns about the impact of illegal immigration on the availability of social services, public education and jobs in Marin County.

This Administration recognizes the enormity of the problem, and is committed to stemming the influx of illegal aliens. In February, we undertook a major new initiative which included enhancing border interdiction, reducing the magnet effect of employment in the United States, deporting alien who commit crimes in this country, and improving the process of legal immigration.

Under this initiative, we added 300 new border patrol officers and 200 new Immigration and Naturalization (INS) investigative agents, and began replacing 1.5 million easily counterfeited work authorization documents ("green cards") with counterfeit-resistant documents.

We continue to press for legislation expediting deportation of criminal aliens and aliens arriving with fraudulent documents. Moreover, the President's FY 1993 budget requests more criminal alien investigators and a new border detention facility in Southern California. Finally, the President is committed to a long-term solution to illegal immigration, and therefore strongly supports the North American Free Trade Agreement.

Your views are persuasive and are highly appreciated.

Sincerely,

Clayton Yeutter

Clayton Yeutter
Counsellor to the President
for Domestic Policy

cc: Mr. Bill Weeks

Christine Hugh Ramberg
William Weeks
CPBA
P.O. Box 9636
San Rafael, CA 94912

CS

CPBA

CANAL AREA PROPERTY AND BUSINESS OWNERS ASSOCIATION
Post Office Box 9636, San Rafael, California 94912

June 16, 1992

Clayton Yuetter, Chief Domestic Advisor to President Bush
The White House
1600 Pennsylvania Ave., N. W.
Washington, D.C. 20500

Dear Mr Yuetter:

We are writing to you to seek Federal assistance with a matter that we have been attempting to address at our local (city, county, state) level for some time with no success. Our concerns center around problems of increased crime and deteriorating conditions due to a recent and massive influx of foreign nationals into our neighborhood, city and state.

The Canal Property and Business Owners Association is a 1400 member San Rafael grass-roots organization formed to address the rapid downward spiral of conditions in our neighborhood brought about primarily by a rapid increase of illegal immigrants into our city with its attending problems of increased trash, extreme overcrowding, loitering, graffiti, prostitution and drugs. Our city officials are unwilling to take a stand on this issue, claiming that it is a Federal problem and thus "there is nothing that they can do." The only cooperation we have received has been from our local I.N.S. office and their efforts have been appreciated. But they are restricted in what they can do because of limited manpower and limited funding.

As we are all aware, the voters and taxpayers of this country are in a major state of frustration and malaise. In our attempts to get anyone in government to address this problem, we have acquired a file of petitions and letters in less than nine months that is over seven inches thick. Our file also includes substantial photographic evidence of these problems. All of our data has been ignored by our local and state politicians. It is obvious to us why many voters are looking for alternative candidates such as Ross Perot who are willing to tackle difficult issues. Our needs as U.S. citizens are just not being appropriately addressed at this time.

We are not opposed to legal immigration. In fact, as the sons and daughters of past immigrants, we believe that our immigration policies provide a method of creating a stronger and more diverse culture. But our local politicians refuse to differentiate between legal and illegal immigration. The result of their lack of attention to our laws is drastically effecting the quality of our lives, the quality of education of our children, and the quality of our environment.

It seems that the U.S. Government's policy is to make exceptions for foreign nationals who knowingly break the laws of this country by entering illegally. It is absurd to have laws that

schools are mandated by law to provide "bilingual" education. This is not only costly, but ultimately hurts those children because they fail to learn enough English to fully function in the U.S. or in the international business arena. English speaking children in bilingual schools are also being hurt since they are losing a good deal of teaching time. Because courses are taught in both languages they are, in effect, only getting one-half of an education. Their school day is no longer than those schools teaching courses in one language. This is unfair and one of the primary reasons our public schools are failing our children and, in California, going bankrupt.

We as taxpayers, therefore look to our Federal government to protect our rights, and request that <u>REAL</u> enforcement of our immigration and employment laws become a priority. If we do not do so, we are in effect sending a message to foreign nationals that it is alright to ignore the laws and values of this country. Ultimately the fabric of our society will break down because disrespect for our laws will continue to escalate as individuals see that our Federal laws can be broken with impunity.

We trust that this letter will be read and that appropriate action will be taken by our Federal officials. And, please be aware that we are willing to help you in any manner that we can. As individuals or as a group we would be willing to travel to Washington D.C. to furnish you with first hand information about this critical situation. We believe that it is absolutely necessary that Congress and our administration fully understand the severity as well as impact of this problem on our neighborhoods. Only then will they have the information they need to take the appropriate steps needed to protect our state and country.

We look forward to hearing from you.

Sincerely yours,

Christine Hughes Ramberg　　　　Bill Weeks
CPBA Co-chairs

cc: Messrs. Brandon, Ilchert, Roman, I.N.S.
President George Bush
Gene McNary
Vice President Dan Quayle
Governor Pete Wilson

W HITE HOUSE
  HINGTON

29 USA

The Honorable William P. Barr
Attorney General
Department of Justice
Room 5111
Washington, D.C. 20530

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: PETERSMEYER, C. GREGG, ASST. TO THE PRESIDENT, WHITE HOUSE
To: AG.
ODD: NONE
Date Received: 07-17-92 Date Due: NONE Control #: X92071710798
Subject & Date
07-10-92 MEMO ATTACHING A COPY OF THE MEMORANDUM ISSUED BY PRESIDENT BUSH REGARDING THE ATLANTA PROJECT, AND COPIES OF NEWSPAPER ARTICLES FROM THE "ATLANTA JOURNAL" AND THE "ATLANTA CONSTITUTION" WHICH PUBLICLY DISCLOSE THE PRESIDENT's COMMITMENT TO FEDERAL COOPERATION WITH THE ATLANTA PROJECT. ADVISES THAT THE PRESIDENT's DIRECTIVE WAS WELL RECEIVED.
(SEE EXEC. SEC. 92070210055 CONTROL SHEET ATTACHED.)

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	07-17-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

10 July 92

Remarks
CC INDICATED FOR: DAG.
INFO CC: ASG.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
7/17/92 JRH FYI
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL
CROSS REFERENCES:
1. ARTICLES

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

'92 JUL 17

July 10, 1992

MEMORANDUM FOR THE ATTORNEY GENERAL

FROM: C. GREGG PETERSMEYER
ASSISTANT TO THE PRESIDENT
AND DIRECTOR, OFFICE OF NATIONAL SERVICE

SUBJECT: Presidential Memorandum Regarding the Atlanta Project

Attached is a copy of the memorandum issued by the President regarding the Atlanta Project. The memorandum was sent to most Federal department and agency heads directing them to instruct their regional offices in Atlanta to cooperate with the Atlanta Project in its effort to aid the poorest residents of Atlanta.

A copy of this memorandum was sent to Deputy Attorney General Terwilliger as he represented the Department of Justice at the meeting with former President Carter on April 20. Henceforth, any materials pertaining to this matter will be directed to your attention.

Also attached are newspaper articles from the Atlanta Journal and the Atlanta Constitution which publicly disclose the President's commitment to Federal cooperation with the Atlanta Project. As you will read, the President's directive was well received.

cc: Deputy Attorney General Terwilliger

THE WHITE HOUSE

WASHINGTON

July 1, 1992

MEMORANDUM FOR THE SECRETARY OF AGRICULTURE
THE SECRETARY OF LABOR
THE SECRETARY OF HEALTH AND HUMAN SERVICES
THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY OF EDUCATION
THE DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET
THE DIRECTOR OF THE OFFICE OF PERSONNEL MANAGEMENT
THE DEPUTY ATTORNEY GENERAL

SUBJECT: The Atlanta Project Directive

As you know, I am committed to reforming the Federal Government so that it provides its services as effectively and efficiently as possible. An indication of this commitment is our effort to increase flexibility that furthers education reform and the granting of welfare waivers to certain States.

Individual cities and States can help the Nation better understand how Federal, State, and local governments can work together to solve social problems. As you know, I met with former President Carter to discuss the Atlanta Project, an initiative of the former President, the Carter Center, and Atlanta's residents to address the problems of the poorest families in Atlanta. At that meeting, I indicated support for the meeting you attended with former President Carter to discuss the Atlanta Project.

I am directing that you instruct your regional offices that serve Atlanta to give their full support to improving government efficiency and effectiveness while cooperating with the Atlanta Project and initiatives in other cities that seek Federal cooperation. This means: (1) to use flexibility in decisions the regional offices are capable of rendering at the local level

to ensure efficient and effective coordination in the delivery of services; (2) to coordinate among regional offices to reach decisions that would improve the efficiency and effectiveness of government service delivery; and (3) to expeditiously relay to respective department and agency heads and the White House decisions that require higher level review.

Further guidance about the process of coordination within the executive branch will come from the Counsellor to the President for Domestic Policy.

G Bush

THE WHITE HOUSE

WASHINGTON

July 1, 1992

MEMORANDUM FOR THE SECRETARY OF THE TREASURY
THE SECRETARY OF DEFENSE
THE SECRETARY OF THE INTERIOR
THE SECRETARY OF COMMERCE
THE SECRETARY OF TRANSPORTATION
THE SECRETARY OF ENERGY
THE SECRETARY OF VETERANS AFFAIRS
THE DIRECTOR OF THE ACTION AGENCY
THE CHAIRMAN OF THE COMMISSION ON CIVIL RIGHTS
THE CHAIRMAN OF THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION
THE ADMINISTRATOR OF THE ENVIRONMENTAL PROTECTION AGENCY
THE CHAIRPERSON OF THE FEDERAL DEPOSIT INSURANCE CORPORATION
THE DIRECTOR OF THE FEDERAL EMERGENCY MANAGEMENT AGENCY
THE CHAIRPERSON OF THE FEDERAL HOUSING FINANCE BOARD
THE ADMINISTRATOR OF GENERAL SERVICES
THE CHAIRMAN OF THE INTERSTATE COMMERCE COMMISSION
THE ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION

SUBJECT: The Atlanta Project Directive

As you know, I am committed to reforming the Federal Government so that it provides its services as effectively and efficiently as possible. An indication of this commitment is our effort to increase flexibility that furthers education reform and the granting of welfare waivers to certain States.

Individual cities and States can help the Nation better understand how Federal, State, and local governments can work together to solve social problems. Former President Carter recently met with me, and on a subsequent occasion with several members of the Cabinet, to discuss the Atlanta Project, an initiative of the former President, the Carter Center, and Atlanta's residents to address the problems of the poorest families in Atlanta. I indicated to President Carter my desire to have the Federal Government be responsive to the needs of the project.

I am directing that you instruct your regional offices that serve Atlanta to give their full support to improving government efficiency and effectiveness while cooperating with the Atlanta Project and initiatives in other cities that seek Federal cooperation. This means: (1) to use flexibility in decisions the regional offices are capable of rendering at the local level to ensure efficient and effective coordination in the delivery of services; (2) to coordinate among regional offices to reach decisions that would improve the efficiency and effectiveness of government service delivery; and (3) to expeditiously relay to respective department and agency heads and the White House decisions that require higher level review.

Further guidance about the process of coordination within the executive branch will come from the Counsellor to the President for Domestic Policy.

G Bush

THE ATLANTA JOURNAL
Thursday, July 9, 1992
Page A1

Bush helps cut red tape for Atlanta Project

Carter hails 'leeway to try new ideas'.

By Rebecca Perl
STAFF WRITER

In an effort that could make aiding the urban poor easier, President Bush has given Jimmy Carter and his Atlanta Project "unprecedented" authority to cut through the red tape of federal bureaucracy.

A meeting with Mr. Bush in Washington earlier this year has "paid good dividends," Mr. Carter said today.

As a result, Mr. Bush has ordered a directive for federal agencies in the Southeast that "gives us some unprecedented leeway to try new ideas," Mr. Carter said.

The ideas will probably include the creation of one simple, single form that would allow a poor family to get food stamps, Medicaid and public housing all at once without the hassle of a mountain of paperwork and the headache of dealing with a morass of public agencies.

For instance, application forms for Medicaid and other assistance can run 30 pages. As Mr. Carter likes to point out, poor people don't have secretaries. Many do not read well enough to understand the forms.

One of Mr. Carter's strategies with the Atlanta Project has been to simplify things so that members of poor communities can have their needs addressed through one, central institution in the neighborhood.

In this way, elderly residents, who often don't have cars or drive, who must now trudge all over town, registering with different agencies, could get their needs met without ever leaving their community.

Please see CARTER, A8 ▶

Carter: Atlanta Project gets helping hand from Bush

▶ Continued from A1

Mr. Bush's directive also could be used to bypass federal laws that now require boarding up of large public housing units, like those that sit empty in East Lake Meadows and other public housing projects in Atlanta because a large family isn't immediately available to move in.

Mr. Carter hopes to move needy families into these units no matter the size of the family.

If these ideas work in Atlanta they might be implemented nationwide.

The Atlanta Project is Mr. Carter's ambitious plan to raise an army of volunteers to alleviate the miseries of poverty, including homelessness, teen pregnancy, unemployment, alarming high school dropout rates, violence, drug addiction and juvenile delinquency.

The former president has been largely successful at getting local and state agencies, private companies and civic groups to agree to join his effort to take on Atlanta's social ills.

Today's announcement represents his success in signing on the federal government as well.

Raymond Harris, regional administrator for Housing and Urban Development, will serve as the liaison between the Atlanta Project and federal agencies that serve the Southeast.

THE ATLANTA CONSTITUTION
Friday, July 10, 1992
Page A1

Atlanta Project can ignore red tape

'Unprecedented leeway:' Bush has told federal bureaucrats to allow experimentation.

By Rebecca Perl
STAFF WRITER

To simplify delivery of services to the poor, President Bush Thursday gave Jimmy Carter and his Atlanta Project "unprecedented" authority to sidestep federal bureaucracy.

A meeting with Mr. Bush in Washington several months ago "paid good dividends," Mr. Carter said Thursday.

As a result, Mr. Bush has ordered federal agencies responsible for the Southeast to provide "some unprecedented leeway to try new ideas," Mr. Carter said.

Jimmy Carter got "big dividends" from his discussion of his project to tackle Atlanta's social ills.

The Bush directive calls on federal agencies to allow the Atlanta Project to circumvent federal policies that can jam up attempts to help the poor get jobs, housing, food and health care.

Armed with the directive, Mr. Carter and his soldiers can begin immediately to create a simple, single form that would allow a poor family to get food stamps, Medicaid, and public housing, for example.

As it stands now, it can take 30 pages of paperwork and months of delays to get a single service, such as infant formula for a new baby. As Mr. Carter likes to point out, poor people don't have secretaries. Many do not read well enough to understand the forms.

One of Mr. Carter's strategies has been to cut bureaucratic red tape so that members of poor communities can have

Please see RED TAPE, G3 ▶

Red tape: Order arms Atlanta Project to simplify federal services to poor

▶ Continued from G1

their needs addressed quickly and easily through one, central institution in the neighborhood.

In this way, elderly residents, who often don't have cars or drive but now must trudge all over town registering with different agencies, could get their needs met without ever leaving their communities. They have already begun working to find ways to implement such programs, but are not sure when they will be ready.

Mr. Bush's directive could also be used to bypass federal laws that now require boarding up large public housing units, like those that sit empty in East Lake Meadows and other public housing projects in Atlanta because a large family isn't immediately available to move in.

Mr. Carter hopes to move needy families into these units no matter the size of the family.

Organizers in the deteriorated Summerhill neighborhood welcomed the news. They are trying to cut through Department of Housing and Urban Development red tape to turn the Martin Street Plaza public housing project into tenant-owned apartments.

"HUD told us we've got to do a $6,000 appraisal of Martin Street, and we know they can waive that," said Douglas Dean, president of Summerhill Neighborhood Inc., a non-profit redevelopment organization. "Now with this executive order from the president, we're going to go to HUD and ask them. It could be a tremendous help for us."

If such schemes work in Atlanta they might be implemented nationwide.

The Atlanta Project is Mr. Carter's ambitious plan to raise an army of volunteers to alleviate the miseries of poverty, including homelessness, teen pregnancy, unemployment, alarming high school dropout rates, violence, drug addiction and juvenile delinquency.

The former president has been largely successful at getting local and state agencies, private companies and civic groups to agree to join his effort to take on Atlanta's social ills.

Thursday's announcement represents his success in signing on the federal government as well.

Michelle Hisky contributed to this report.

THE WHITE HOUSE
WASHINGTON

WASHINGTON JUL 13 '92 DC
US POSTAGE 0.52
6024934

FROM
THE WHITE HOUSE
WASHINGTON, D.C.

The Attorney General
Department of Justice
Tenth Street and
   Constitution Avenue, N.W.
Washington, DC 20530

FIRST CLASS

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRES./DOMESTIC POLICY
To: AG.
ODD: NONE
Date Received: 07-09-92 Date Due: NONE Control #: X92070910350
Subject & Date
07-09-92 MEMO REGARDING THE AG'S LAW ENFORCEMENT PROPOSAL.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	07-09-92	(5)			W/IN:
(2)			(6)			
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(4)			(8)			1P

INTERIM BY: DATE: OPR:
Sig. For: OAG Date Released: MAU

9 July 92

Remarks
(1) TO OAG FOR ACTION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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THE WHITE HOUSE
WASHINGTON

'92 JUL -9 P4:52

DATE: Jul. 9, 1992

EXECUTIVE SEC...

TO: Attorney General Barr

FROM: **CLAYTON YEUTTER**
Counsellor to the President for Domestic Policy

Bill, Jeanne and I are off tomorrow morning for a long weekend in Florida, but I wanted you to know that I'm taking your law enforcement proposal with me. I've already perused it, and like a lot of what I see. There is no doubt in my mind about our need to have a bold proposal for you and the President to surface between now and November. We should, in fact, have more than one Presidential event in my opinion. And we need to get him talking about this subject more than he has in the past.

In the latter regard, it'll help when we get him a 10 minute presentation, as I discussed with you a couple of weeks ago. I've tasked people to do about 10 other domestic topics in a similar way, and would like to pull all those together for him by the end of next week so he can digest them before the campaign gets fully underway. Hope you can make that timetable.

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: BARNETT, JANE E., OFFICE OF PUBLIC LIAISON, THE WHITE HOUSE
To: KEY CONTACT (AG.) ODD: NONE
Date Received: 07-10-92 Date Due: NONE Control #: X92071310430
Subject & Date
06-30-92 LETTER ENCLOSING A COPY OF THE TEXT OF AN ADDRESS PRESIDENT BUSH DELIVERED ON JUNE 25, 1992, TO AN AUDIENCE ON THE SOUTHLAWN OF THE WHITE HOUSE IN A CEREMONY FOR G.I. BILL OPPORTUNITY SCHOLARSHIPS FOR CHILDREN, ALONG WITH A WHITE HOUSE FACT SHEET THAT DESCRIBES THIS BILL IN GREATER DETAIL.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	07-13-92	(5)			W/IN:
(2)			(6)			
(3)			(7)			PRTY:
(4)			(8)			1

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

30 June 92

Remarks
INFO CC: DAG, ASG, OLA.
(1) FOR INFORMATION.
(SEE EXEC. SEC. 92080411650.)

Other Remarks:

OLA CONTACT:
JRH 7/15/92
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

THE WHITE HOUSE

WASHINGTON

'92 JUL 10 P3:34

June 30, 1992

Dear Key Contact:

On June 25, 1992, President Bush delivered an address on educational choice to an audience of 1,500 students, parents, teachers, and educators on the South Lawn of the White House. In his remarks, the President announced the transmittal to Congress of the "GI Bill for Children." If approved, this initiative would appropriate $500 million federal dollars in Fiscal Year 1993, and additional amounts in later years, to help states and communities provide $1,000 scholarships to children of middle- and low-income families. These monies may be spent at any lawfully operating school -- public, private, or religious.

The President expects that the passage of this legislation will encourage many state and local governments to enact their own educational choice programs. The President stated that, "For too long, we've shielded our schools from competition -- allowed our schools a damaging monopoly power over our children. And this monopoly turns students into statistics and turns parents into pawns. And it is time we began thinking of a system of public education in which many providers provide a marketplace of opportunities -- opportunities that give all of our children choices and access to the best education in the world."

The President is firmly committed to educational choice for all Americans but his dream of equal access to all schools for all children cannot be realized alone. We will need your continued support and leadership both on the national level and on the local level in encouraging your state and local governments to enact their own choice legislation and participate in the GI Bill for Children program.

I have enclosed the text of the President's address as well as a White House fact sheet that describes the GI Bill For Children in greater detail.

If you have any questions or I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Jane E. Barnett

Jane E. Barnett
Associate Director
Office of Public Liaison

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release June 25, 1992

REMARKS BY THE PRESIDENT
IN CEREMONY FOR G.I. BILL OPPORTUNITY SCHOLARSHIPS FOR CHILDREN

The South Lawn

10:20 A.M. EDT

THE PRESIDENT: Welcome, all. Hey, we're glad you guys are here. Welcome, welcome, and pleased be seated. All you kids, welcome to the South Lawn of the White House. And to the Vice President and Mrs. Quayle and Secretary Alexander, a warm welcome. A particularly warm welcome to the members of Congress, both House and Senate, that are with us today. Welcome to all of you, our very special guests, on this special occasion.

I have just come from a working session in the White House, working with some of the great experts on school choice. And the parents, I think, made the most significant contribution to our working session because their dreams for their kids are the same dreams that all of us have. And they want their kids to have a first-class education. And they know from practical experience that a good education is absolutely essential to making a good living and to making a good life.

So let me just share a little from that meeting. Janette Williams told me about her son, Javon. The Williamses are here with us somewhere here today -- whoops, here she is over here. Her kid starred on 60 Minutes, and that says something about the guy. If you go on that program and come off in one piece, he must be doing real well. (Laughter.) But she gave us -- here's what she said -- and this is serious. She said: "At his old school that was crowded, he used to get so bored that he would walk out. And thanks to the choice program in Milwaukee, he's at a new school. And he's not doing those things anymore. He's doing his homework; he's even helping clean up the classroom after school. And they took the energy and turned it around."

Now, the Governor here, Tommy Thompson, the Governor of Wisconsin, is here with us today. I'm sorry that Polly Williams, who's been at the forefront of the school choice movement couldn't be here, but she's at home looking after her mother. I would salute her values, but we miss her very, very much. Together, Polly and Tommy Thompson, the Governor, have taken the lead in helping parents like Janette Williams realize her dreams for her son Javon -- creating scholarships for 1,000 Milwaukee children from low-income families so that they can attend private schools. Now, theirs is a bold experiment, to give low-income families more of the same choices of schools already available to wealthier families.

Mike Joyce of the Bradley Foundation was also in our meeting. And Bradley recently joined with other foundations and Milwaukee businesses to raise $3 million dollars so that Milwaukee's low-income families will be able to choose their family's schools, including the religious schools. Mike told us this morning that parents picked up every one of the 4,500 scholarship applications, the day after the scholarships were announced -- 4,500, that fast. And don't let anybody tell you that the people of Milwaukee don't care about their kids' education.

No one should underestimate what's at stake here. A revolution is underway in Milwaukee and across this country, a

MORE

revolution to make American schools the best in the world. And I salute out Secretary of Education who is helping lead that revolution, Lamar Alexander. (Applause.)

Together with the nation's governors, we've set six ambitious national education goals. And I might say that this wasn't a partisan move; Democrats and Republicans alike of the governors coming together to set six ambitious national education goals. And in 44 states and 1,400 communities, we've already launched America 2000 to meet these goals.

Even earlier, still, in January 1989, just before I was sworn-in as President, we helped organize the White House Conference on Choice in Education. We believed then and we believe today, a few fundamental truths. We believe that parents are their children's first teachers. (Applause.) Parents, not bureaucrats, know what's best for their kids.

And at this point I would like to salute one of the two in purple, Barbara Bush -- (laughter) -- for her pointing this out to parents. That it's what they do, what happens in their home. (Applause.) And Barbara's done a lot of that here and around the country. And I might say that Marilyn Quayle's taking that same message of parental involvement all across our country, and we're very grateful to her. (Applause.) So it is our belief, then, that parents, not the government, should choose their children's schools.

And so today I am proposing that we take another giant step forward in this revolution. And I am sending to Congress legislation that would authorize an amibitious demonstration program, a $1.5 billion new federal dollars to help communities all across America give $1,000 scholarships to children of middle and low-income families, so they can choose which schools their kids will attend. (Applause.)

This revolution is in the greatest American tradition, and we've done it before and it's worked. Forty-eight years ago this very week, President Roosevelt signed the GI Bill, creating scholarships that veterans could use at any college -- any college of their choice. The GI Bill created opportunity for Americans who never would have had it, and in doing so it helped create the best system of colleges and universities in the world.

And now we can do that again, this time by helping state and local governments -- and we're delighted the Mayor of Milwaukee is with us here today -- this time by helping state and local governments create the best elementary and secondary schools in the world. The GI Bill for children will help. It'll provide that help to these families. These dollars to spend at the schools of their choice will become the muscle that parents need to create the best schools for their kids.

Let me say to those who will attack our school choice initiative on the ground that it permits government money to go to religious schools, you're wrong. I believe those critics are wrong. This is aid to the families, not aid to institutions. (Applause.) And, again, if you set the clock back to the creation of that original GI Bill, no one told the GIs that they couldn't go to SMU or Notre Dame or Yeshiva or Howard. I haven't heard members of Congress suggest that students stop using Pell Grants and guaranteed student loans at Baptist colleges or Presbyterian seminaries. I don't hear an outcry because poor children at Catholic schools get their lunch paid for by federal taxpayers. In the same way, parents must be free to use this money at the school they believe will best teach their child, whether that school is public, private or religious. (Applause.)

MORE

Let me try to be clear on this point: Accepting students with vouchers does not mean a school must sacrifice school prayer. And let me say this to those who stand against extending school choice to low-and middle-income families: I simply do not buy the idea that someone cannot make a good decision just because that person is poor. (Applause.) We heard the same argument when we proposed child care vouchers for low-income families, or when we proposed help for public housing tenants to own their own homes. And so it's my belief that we ought to let families own their own home and choose their own schools regardless of their income level -- and give them help. (Applause.) Give them a shot at the American Dream, if you will.

And finally, to those who claim that school choice will hurt the public schools, let me underscore this point: All of this new money can go to public schools if that's where the child chooses to go -- where the family choose to have the kid go. And that decision will be in the hands of families -- where it belongs.

There are several points to make about money. First, I want to make it clear that we're not talking here about a new federal entitlement program. The federal government cannot afford one more entitlement, even for education. And I've said many times that money alone isn't the answer. The United States already spends more per student for schools than any country in the world except Switzerland. And I don't have to tell you where we stand in the international rankings of educational performance at the level we're talking about here today.

Our universities and colleges are respected and have achieved the highest levels of achievement. But that, unfortunately, is not true as we talk about K-12. So we need a revolution in American education -- not more money to do it the same old way.

Investment in our schools will remain a primarily state and local responsibility. But federal support for state and local scholarships can be a catalyst. For schools that attract choice students, it will give teachers and principals a welcome source of new funds. And for our children, choice can help open up opportunities, create genuine change in our schools.

For too long, we've shielded schools from competition -- allowed our schools a damaging monopoly power over our children. And this monopoly turns students into statistics and turns parents into pawns. And it is time we began thinking of a system of public education in which many providers offer a marketplace of opportunities -- opportunities that give all of our children choices and access to the best education in the world. (Applause.)

And so it is our firm belief -- it is our firm belief that this GI Bill for Children will move America inevitably in that direction.

Abraham Lincoln once said: "Revolutions do not go backward." Milwaukee is not the only place in America that our revolution is underway. Last year in Indianapolis, Pat Rooney and the Educational CHOICE Charitable Trust began to offer tuition vouchers to Indianapolis students. And I understand a busload of parents and students drove all night to be here today. And if you're still awake, welcome -- a special welcome to all of you. (Applause.) In San Antonio, the CEO Foundation has earmarked $1.5 million in vouchers for children in their community.

California -- Joe Alibrandi and thousands of supporters are pushing for a ballot initiative to provide voucher scholarships for every school-age child in the state. And overall, in 1991, 10 states approved some form of new choice legislation. And 37 states had choice legislation pending in one form or another.

MORE

And I've been told that there may just be a few folks here from Pennsylvania. (Applause.) We're outnumbered. Well, it may take a few tries, but I never underestimate the persistence of parents: The Children of Pennsylvania will have school choice. (Applause.)

From California to East Harlem, from coast to coast, the leaders of the school choice movement are sparking a revolution in American education. And they're the true heroes of this education reform, and some of them are here with us today.

They aren't afraid to stand up to the status quo -- to say, loud and clear, that when it comes to educating our kids, business-as-usual simply isn't good enough. (Applause.) Let there be no mistake: Barbara and I and the Vice President and Marilyn, and certainly our Secretary, are very proud to stand with you.

You see, this revolution will succeed. And it will succeed because it draws its strength from the very heart of the American creed. We have no truth more enduring than the idea that every American should have the opportunity for a first-class education.

We have no principles more important than freedom, opportunity and choice. (Applause.)

So thank you very, very much. And look at it this way, you're doing the Lord's work for our nation's future. And you're doing for the young people of this country. (Applause.) And we are grateful to all of you. And may God bless the United States. And now I will sign this. (Applause.)

END 10:35 A.M. EDT

STATE AND LOCAL GI BILLS FOR CHILDREN

The Proposal: Half-a-billion new Federal dollars to help States and communities give each child of a middle- and low-income family a $1,000 annual scholarship that families may spend at any lawfully operating school of their choice--public, private, or religious.

The Problem: Today, choosing a school is mainly an option for families wealthy enough to move to a different public school area, or those who can afford private or religious school. Partly because of this lack of choices, our elementary and secondary schools are not meeting the needs of all our children.

The Solution: Give middle- and low-income families consumer power--dollars to spend at any school they choose. This is the muscle parents need to transform our education system and create the best schools in the world for their children.

The Rationale: Just as the GI Bill gave World War II veterans opportunity and consumer power to help create the best colleges and universities in the world, GI Bills for Children will give children opportunity and their parents the consumer power to create the best elementary and secondary schools in the world.

The Legislation: Will give middle- and low-income families more of the same choices available to wealthier families; through families, provide new Federal dollars at the school site that teachers and principals can use to help all children achieve the high educational standards called for by the National Education Goals; create a marketplace of educational opportunities to help improve all schools; engage parents in their children's schooling; and encourage creation of other academic programs for children before and after school, on weekends, and during school vacations.

Eligibility: A competitive 4-year grant program. Any State or locality may apply for Federal funds to give each child of a middle- or low-income family a $1,000 annual scholarship. The governmental unit would have to: 1) take significant steps to provide a choice of schools to families with schoolchildren in the area; 2) permit families to spend the $1,000 scholarships at a wide variety of public and private schools; 3) allow all lawfully operating schools in the area--public, private, and religious--to participate if they choose.

Selection of Grantees: Based on: 1) the number and variety of choices made available to families of eligible children; 2) the extent to which the applicant has provided educational choices to all children, including children who are not eligible for scholarships; 3) the proportion of participating children who are from low-income families; and 4) the applicant's financial support (including private support) for the project.

Supplementary Academic Services: Up to $500 of each scholarship may be used for other academic programs for children before and after school, on weekends, and during school vacations.

Funding: $500 million is authorized in FY 1993, and "such sums as may be necessary" through FY 2000.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release June 25, 1992

Federal Grants for State and Local 'GI Bills' for Children

FACT SHEET

The President today transmitted to the Congress the "Federal Grants for State and Local 'GI Bills' for Children." This bill would authorize $500 million in fiscal year 1993, and additional amounts in later years, to help states and communities provide $1,000 scholarships to children of middle- and low-income families. Each family may spend these scholarships at any lawfully operating school -- public, private, or religious.

The original GI Bill, enacted 48 years ago this week, gave scholarships to veterans to use at any college of their choice, public or private. Veterans used this consumer power to help create the world's best system of colleges and universities.

Today, there is little consumer power for the parents of most elementary and secondary school students. Choosing a school is mainly an option for families wealthy enough to move to a different public school area or for those who can afford a private or religious school. Partly because of this lack of choice and an absence of the competition among schools that choice would create, many children have to attend elementary and secondary schools that do not provide an adequate education. This legislation is designed to give middle- and low-income parents greater consumer power.

The proposed legislation includes the following elements:

Authorized Program

- The Department of Education would make competitive 4-year grants to states and localities for scholarships to children from middle- and low-income families.
- Scholarships would be in the amount of $1,000, plus any additional support available from non-Federal sources.
- Families would use these scholarships to send their children to any lawfully operating school -- public, private, or religious.

- They could also use up to $500 of the scholarship to obtain supplementary academic services for their children.

Eligibility

- Any state or locality can apply for funds sufficient to give each child of a middle- or low-income family a $1,000 annual scholarship. In order to qualify, the governmental unit would have to:

  - Take significant steps to provide a choice of schools to families with school children in the area;

  - Permit families to spend the $1,000 Federal scholarships at a wide variety of public and private schools; and

  - Allow all lawfully operating schools in the area -- public, private, and religious -- to participate if they so choose.

Project Selection

The Secretary of Education would select grantees on the basis of:

- The number and variety of choices made available to families of eligible children;

- The extent to which the applicant has provided educational choices to all children, including children who are not eligible for scholarships;

- The proportion of children who will participate who are from low-income families; and

- The applicant's financial support (including private support) for the project.

Eligible Students

The maximum family income for eligible children would be determined by the grantee, but it could not exceed the higher of the state or national median income, adjusted for family size. (For example, in 1989 the national medium family income for a family of four was roughly $40,000.)

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, THE WHITE HOUSE
To: CONLAN, JOHN B. (CC: AG.)
ODD: NONE
Date Received: 06-25-92 Date Due: NONE Control #: X92062609730
Subject & Date
06-17-92 LETTER (COPY) THANKING MR. CONLAN FOR HIS RECENT LETTER (COPY ATTACHED) IN WHICH HE MAKES SEVERAL SUGGESTIONS FOR PRESIDENT BUSH OVER THE COMING WEEKS.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	06-26-92	(5)			W/IN:
(2)			(6)			
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(4)			(8)			1P

INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

17 June 92

Remarks
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
****

bcc: Porter
Barr
Darman

CLAYTON YEUTTER

June 17, 1992

EXECUTIVE OFFICE '92 JUN 25 P4:55 RECEIVED

The Honorable John B. Conlan
2300 N Street, N.W.
Suite 600
Washington, DC 20037

Dear John:

Thanks for your recent letter suggesting several strategic moves for President Bush over the coming weeks. It was very thoughtful of you to write, and I will share your recommendations with a number of key people here and at the Bush/Quayle campaign.

I'll not comment on the budget/appropriations process since that is not my area of expertise. However, I'm sure that the folks at OMB would love to see many, if not all, of the changes you have outlined. Hopefully, there will be a chance to work on those next year. I do wonder if the President can take a complicated issue like this and discuss it effectively during the campaign. Most Americans just do not understand the process at all.

I strongly share your view on the language question, even though we have lived in South America and speak Spanish. We need to do everything we can to foster the use of English in this country, for those who do not read, write and speak English are at an enormous disadvantage from an economic standpoint.

I also agree wholeheartedly with your comment about enforcing the immigration laws. That issue became much more vivid during the Los Angeles riots, but it is tremendously important irrespective of that situation. Immigrants have made phenomenal contributions to American society, and most of us would not be here were it not for immigrant parents or grandparents. But there is a limit to how rapidly any nation can absorb thousands of immigrants, and the U.S. is no exception.

Thanks, John, for the excellent input.

Sincerely,

Clayton

Clayton Yeutter

JOHN B. CONLAN, ESQ.
ATTORNEY AT LAW

2300 N. STREET, N. W.
SUITE 600
WASHINGTON, D.C. 20037
(202) 663-9028

PLAZA 170
11811 N. TATUM BLVD.
PHOENIX, ARIZONA 85028-1601
(602) 953-6700

PLEASE REPLY TO:

Mr. Clayton Yeuther
Domestic Policy Counsellor
Old Executive Office Bldg.
1600 Pennsylvania Ave., N.W.
Washington, D.C. 20500

May 6, 1992

Dear Clayt,

As a former U.S. Congressman and fellow believer at 4th Presbyterian Church, and former Press Secretary to Billy Graham, I want to share with you two key actions for you and the President to act upon to help keep the conservative vote from going to Ross Perot or staying home.

A. There is an overwhelmingly **strong public feeling of nationalism** sweeping our country, as elsewhere in the world, and there are two key ways President Bush can capitalize on it and strengthen themselves against the Ross Perot factor - and anybody.

1 You and Bush should quietly have House and Senate Republican leaders get most Republicans to vote **against** H.R **4312**, an amendment to the Voting Rights Act of 1965 that would **continue** for **another 15 years** the **prohibition** of states having only **English language ballots**. The liberal Democrats, in appealing to a tiny element of extreme Hispanic nationalists, will probably try and pass it soon...setting up a perfect opportunity for Bush to **veto** it. Then Dan Quayle and he can lead the chorus that "if you're an American citizen, wanting to vote, then by golly our national language of communication is English - not Spanish, Navajo, Apache, Swahili or Russian".

95% of the public would support the White House and Republicans, and 80% of them would go wild in George Bush's behalf. Dan and George, you, and all Republicans, can hammer away at the fact that we don't need to become 2 peoples like Canada, Belgium (French & Flemish) South Africa (English & Afrikaans), Czechoslovakia, or Yugoslavia, etc. For the USA it's "One Country, One People, One National Language"...and if **citizens** don't' want to learn English well enough to **read** the **ballot** then, as many voters are saying, "to heck" with them. All immigrants who became citizens over our 1st 200 years voted in English!

Why encourage this ballot and other official language divisions anymore. (Remember, we're not talking about shopping, playing cards, family conversation, knowledge of foreign language. We're talking about the basic **language** of **citizenship** that unites us as a people.) This **"English only ballots"** is a **fabulously** winning political issue...besides, if we don't now stop this push towards **Spanish** and English as official languages, we're in for trouble!

2 According to Geo. Gallup, (cf. enclosed article) the public is overwhelmingly in favor of strongly **enforcing** the immigration laws. California, Texas, Arizona, Florida, Illinois, etc. which you've got to win, are overwhelmingly in **favor** of totally stemming the flow of illegal refugees and stronger enforcement of our immigration laws.

Bush is correct in rejecting Haitians or any other illegals. He and the Republicans should lead on this issue - not out of knee-jerk nativistic exclusion of immigration, but a clear realization that our **economy**, our **job and welfare structure** and our **culture** can not absorb all the people of the world who want to come here. Bush could easily say next month, "As President of the U.S. I am sworn to uphold our laws, (immigration laws) and defend our borders. Consequently I am asking INS to step up all enforcement procedures, and to report to me by the end of this year what measures I as President, and the Congress as legislators, should take to strengthen our laws and protect our people". We can have a Free Trade Treaty with Mexico...but **de facto** "open borders" is pure political suicide for us Republicans.

A Wall Street Journal editorialist and a few industries who want wide open borders in immigration will hiss a bit, but, shucks, they're nothing at the polls in comparison with the middle and working classes who **have the votes**. Besides, it's the right side of the issue - Can America really afford to be a totally polyglot society and still keep her culture? Previous immigration waves crossed the **oceans,** permanently, and signed on to assimilate into American culture, values, traditions. Due to easy air travel, autos and hiking across our southern **land** border, they now don't have the same desire to assimilate. I'm touching on several nerves here among the masses of the public! But you all can craft your position as you think most effective.

I submit you've got here a pair of interrelated strong issues, **voting in English** and **uncontrolled** immigration. It's a great 1-2 punch to split and isolate the Democrats, while capturing back the Buchanan and Perot oriented voters.

B. The **second key issue** I recommend is for the President and Vice President to **demand** a single **General Appropriations Bill** out of Congress, with a call for the public to elect **only** those Congressmen who will support a **single General Appropriation** Bill in the next Congress...and thereafter. I think this is a dynamite strategy for Bush and Quayle to trump Perot's forthcoming balanced budget plant, as well as trap the Democrats, and here's the arguments to use:

1. **Almost all States** do this successfully.

2. A **General Appropriation** Bill puts the laser beam focus on **all** spending (except for a few major emergency spending bills that can occasionally arise) **by the Congress** and causes a **soon-to-be balanced budget**!

3. Every Congressman is **on the spot**! He currently can fool the people with rhetoric about deficit spending, and proceed to vote "Yes" on a plethora of individual appropriations bills. The lying and deceit will have to stop!

4. The **President has a single easy target** to focus on. If the total annual appropriation spending is too much, he **vetoes** it and forces the Congress to pare it down. If they don't, he vetoes a Continuing Resolution. Congress either submits to him, or they let the government run out of money and the Social Security checks won't come! Then every American citizen and the President, dumps on the "asinine, irresponsible, big spending liberal Democrats" - a perfect target for popular indignation and uprising at the polls!

5. The civil service, military and **all government agency staff can not manage efficiently** if they don't know by the beginning of their Fiscal Year, Oct. 1st, what funds they will have. Good planning and administration in government is crippled when a callous incompetent Congress can't get its appropriations enacted by Sept. 1st.

6. The timetable and reform the President and public should demand is:

   a. **Abolish the Budget Committees**. These are a scam, a cover, a plaything. The only thing that counts are the Appropriations Committee and the Revenue/Finance Committees. They can converse together and estimate revenues.

   b. **Demand** a **General Appropriation bill** (whether it's one volume or 2 volumes for each subcommittee) **by June 15-30** out of Committee and to the Floor.

c. Congress goes home for 4th of July (10 day recess). Newspapers, Congressional staffs and Public scrutinize the projected spending.

d. Congress **debates** the General Appropriation bill the last 2 weeks of July, **votes** the 1st week or two of August. Pass it, send it to President. Then vacation till after Labor Day.

e President **signs it** , **or vetoes** it in **August**. If veto, Congress and he negotiate it out or slug it out in **September** before Oct. 1st. deadline.

With this procedure, you can get to **balanced budgets**, **accountable Congressmen**, and a **better managed bureaucracy**.

I have served as a State Senator, as well as U.S. Congressman. I was in the U.S. House when we passed the Budget Committee "reforms" in the mid 70's. It was a joke, a scam on the taxpayers, a charade. In the state legislature, as in the Congress, the Appropriation Committees can get their job done January-June.

If Bush and Quayle would challenge the Congress to do this reform, he'd have a winning issue, for outclassing Ross Perot's coming budget plan announcement in the next few weeks. (Don't have Dole and Michel lead on this. Prepare them to be an "Amen" chorus afterward, along with the House and Senate Republican Budget Committee Chairman...promise the latter a new chairmanship, perk, project or something. But the Budget Committees are deceptive anachronisms).

I believe I've given you two strategic, winning P.R. issues. Go get 'em and win!

Cordially, your friend and supporter,

Hon. John B. Conlan

THE WHITE HOUSE
WASHINGTON

The Honorable William Barr
Attorney General
Department of Justice
Room 5114
10th and Constitution Avenue, NW
Washington, DC 20530

DOJ EXECUTIVE SECRETARIAT CROSS-REFERENCE RECORD

CONTROL NUMBER: 92051907730

MCBRIDE, TIMOTHY J. Asst to the President

THE ENTIRE DOCUMENT PACKET FOR THE CONTROLLED CORRESPONDENCE INDICATED BY THE ABOVE EX.SEC. CONTROL NUMBER HAS BEEN FILED IN THE FOLLOWING PRIMARY FILE LOCATION WITHIN THE SUBJECT FILES OF THE ATTORNEY GENERAL.

PRIMARY FILE: TRAVEL (NON-AG)/Guidelines

15 MAY 1992

WHITE HOUSE CORRESPONDENCE/GENERAL 15 MAY 92

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: LEONARD, JANE, OFFICE OF PUBLIC LIAISON, THE WHITE HOUSE
To: AG.
ODD: NONE
Date Received: 05-05-92 Date Due: NONE Control #: X92050506979
Subject & Date
04-28-92 LETTER, ON BEHALF OF PRESIDENT BUSH, REPORTING ON THE PRESIDENT'S ACTIVITIES IN CELEBRATION OF THE FIRST ANNIVERSARY OF "AMERICA 2000." ADVISES THAT APRIL 18, 1992, MARKED THE END OF A YEAR DURING WHICH 43 STATES AND OVER 1100 COMMUNITIES NATIONWIDE ACCEPTED THE PRESIDENT'S CHALLENGE AND KICKED-OFF THEIR "AMERICA 2000" EDUCATION REFORM INITIATIVES. DISCUSSES THE PRESIDENT'S MANY EDUCATION ACTIVITIES DURING THE MONTH OF APRIL. **

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	05-05-92	(5)			W/IN:
(2)			(6)			
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INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: EHZ

28 APRIL 92

Remarks
** THANKS THE AG FOR HIS SUPPORT AND EAGERNESS TO HELP REVOLUTIONIZE OUR NATION'S SCHOOLS, W/ENCLOSURES.
(SEE EXEC. SEC. 91041906947 CONTROL SHEET ATTACHED.)
.
INFO CC: DAG, ASG.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
JRH 5/7/92
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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RECEIVED
DEPARTMENT OF JUSTICE

'92 MAY -5 AM 10:46

EXECUTIVE SECRETARIAT

April 28, 1992

Dear Friend:

On behalf of President Bush, it is my pleasure to report to you on the President's activities in celebration of the first anniversary of AMERICA 2000. April 18, 1992 marked the end of a year during which forty three states and over 1100 communities nationwide accepted the President's challenge and kicked-off their AMERICA 2000 education reform initiative.

The President continued his many education activities throughout the month of April. On April 7, the President congratulated Thomas Fleming of Ann Arbor, Michigan as the 1992 Teacher of the Year in a Rose Garden ceremony. The following morning, on Great American Read-Aloud Day, the President read a story to a class of 1st graders from St. Peters Catholic School in South East Washington to reinforce the importance of reading with children.

On April 16, the President addressed the Lehigh Valley school community in Allentown, Pennsylvania. During his address, the President reinforced his strong support for educational choice. As you know, the President is a strong believer in parental choice, to both improve our schools through free market competition and to enable parents to guide the style, quality, and content of their child's education. In Allentown, the President stated, "For far too long, we've shielded our schools from competition -- allowed the system a damaging monopoly power over students. Well, just as monopolies are bad for the economy, they're bad for our kids. Every parent should have the power to choose which school is best for his child -- public, private or religious. ... Whether it's public school on your street or the one across town -- whether it's private, parochial, yeshiva or bible school -- let parents, not the government, make that choice."

In Allentown, the President also announced his new proposal, the Lifetime Education and Training Act. This act would create a line of credit -- a package of grants and loans worth $25,000 to every eligible American -- to use to further their education or acquire new job skills to make the most of their abilities.

Also this month, the President honored the winners of the United States Academic Decathlon and the National Science Olympiad.

The President is leading a crusade to transform American Education. He has told Congress that he will not accept more Washington "business as usual." Recently he stated "...let me serve notice on the lobby, the education lobby and their friends back on Capitol Hill: One year ago, I asked you to join me in a revolution -- a revolution

to be a part of AMERICA 2000. The time has come to get on board or get out of the way and stay behind. No more business as usual."

I have included copies of the President's remarks from the Teacher of the Year and Academic Decathlon ceremonies, his trip to Lehigh Valley, Pennsylvania, and a fact sheet about the AMERICA 2000 anniversary.

Thank you for your support and eagerness to help revoluntionize our nation's schools. If you have any questions about the enclosed materials, please do not hesitate to call me at (202) 456-7845.

Sincerely,

Jane B. Leonard

Jane Barnett Leonard
Associate Director
Office of Public Liaison

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release April 7, 1992

REMARKS BY THE PRESIDENT
IN HONORING TEACHER OF THE YEAR THOMAS FLEMING

The Rose Garden

11:22 A.M. EST

THE PRESIDENT: Thank you, Lamar, and welcome, everybody, to the Rose Garden. In addition to our outstanding Secretary Lamar Alexander, we have with us Gordon Ambach of the Council of Chief State School Officers; Superintendent Schiller and Michael Emlaw from Michigan; the kids here from Jefferson Junior High and St. Rita's School; and of course, the folks that I just had the pleasure of meeting in the Oval Office, Tom, Diane and Malcolm Fleming, and Diane's mother, Josephine Rosinski.

Why don't you all stand up so they can officially welcome you. (Applause.)

Thank you. Now, we're all here today to salute and thank the thousands of outstanding men and women who educate this nation's children. There's no calling greater than a teacher's because there is nothing more precious than what they touch -- the minds of our youth.

The Talmud says teachers are our "protectors" -- and that's true. By teaching our kids what we've learned and by teaching them to dream, teachers protect the treasures of our past and the promise of our future.

Today I want to share a story about a Detroit kid brought up by his grandparents, Gordon and Carrie Bell Starks. He struggled in school, was labeled a slow learner. And when he dropped out of high school he couldn't read or write or spell. He didn't think that mattered, but one day it did. His faith became tremendously important to him. And he wanted to read the Bible, but he couldn't -- didn't know how.

From that moment, he thought about what it would really mean to take charge of his life. And that moment changed his life. And five years later, after he dropped out, he enrolled in night school to learn how to read his Bible and earn his high school diploma. He went on to Bible College while working as a minister to kids like himself in northwest Detroit. And here he found he had the power to touch and to change lives.

He decided to become a teacher and worked with forgotten kids at a state institution for juvenile offenders. And there's an old saying, "Whoever would be a teacher of men, let him begin by teaching himself before teaching others, and let him set an example before teaching by word." And that's exactly what the young man of this story did. And we're here today to honor him as the 1992 Teacher of the Year -- Thomas Fleming. (Applause.)

He's a hero -- a man of great strength, of courage and great heart. And for the last 20 years as lead teacher in the Washtenaw County Juvenile Detention Program, he's taught history, government, and also geography to kids in the 12-16 age bracket. But he teachers much, much more.

MORE

To kids who had the hope drained out of them by a vicious cycle of abuse, neglect, failure, drugs, crime, he gives life training. And here's what he says to them: "Knowledge is power. The more you know the more you're worth." In these throw-away kids he installs pride.

Tom doesn't want the moon for his kids; he want's something more important -- a future. And in his classroom it will be a future forged out of new personal responsibility, enthusiasm and learning and, yes, hope.

Some of his kids have gone on to respected civic and religious positions. One even rebuilt Tom's original youth club as a ministry of his own. And one of his kids, "Saturday Night Live" comedian, A. Whitney Brown, is here with us today.

Whitney, please stand up, and welcome. (Applause.) And I'm glad you didn't bring Dana Carvey. (Laughter.)

No, but this guy spoke for many of Tom's kids when, more than 20 years after being taught in his classroom, he dedicated his book, The Big Picture, to Tom and to his colleague Anne Klein, who is also here today. And he called them, "two teachers who made a difference.

Well, I have a feeling this crystal apple over here isn't as important to Tom as his other rewards -- seeing the first spark of light in a kid's eye, or even just having a kid who never before had been able to read ask him for a book from the public library. But the apple does symbolize the respect with which Tom's country views him. And the apple reminds us of Tom's message: Education is important because every life can be redeemed; every life counts.

Whether you're concerned about the big issues that shape our world or about the values close to home, education is a fundamental part of the three precious legacies Americans take to heart: strong families, good jobs, a world at peace. Every day on the most intense and personal level, Tom Fleming sees the heart of the problems we face: the breakdown of families, the loss of traditional values, the lure of crime and substance abuse, the dead end of unemployment and hopelessness.

But he knows that good teachers will help us find a solution. For with every student you teach you shape a future and you touch a lifetime. But teachers cannot exist in isolation. Our tremendous respect for them and our utter conviction that education is the key to our country's future led us to develop America 2000, a revolutionary blueprint for educational reform.

It will lead us to achieve our six national education goals, adopted, as you may remember, more than two years ago in an extraordinary nonpartisan federal-state partnership by the nation's governors and by this administration. And let me remind you just briefly of these six goals which will propel this nation forward into excellence.

By the year 2000 our children will start school ready to learn; America's students will achieve at least a 90-percent high school graduation rate; they will demonstrate competence in five core subjects measured against world-class standards. And by the year 2000 our children will be the first in science and math; our adults will be literate and able to compete in the work force; and sixth, finally, our schools will be safe, disciplined and drug-free.

We'll achieve these goals by advancing four transforming ideas at the heart of America 2000. First, flexibility for teachers and principals. Freedom from the web of federal regulations that

MORE

impose a "one size fits all" solution to our schools. Second, a generation of new American schools. Teachers are critical to this exciting break-the-mold experiment in what education can be.

And third, world-class standards and voluntary national exams. Again, teachers are leading the way in defining standards, creating curriculum frameworks, developing exams to help us raise our sights and measure our performance. And fourth and finally, parental choice of schools -- public, private, religious.

Now, our plan is innovative. It is exciting. It is uniting this country and it will work. Changing our schools is too important to wait or to waste a generation. And that's why education is one of the five urgent reform challenges that I've been talking about. We know we've got to be competitive in a changing world. We can't go on sending our children into the working world under-educated and ill-equipped and expect the business community to spend billions teaching new workers what they should have learned in school. Status quo schools simply will not carry us into the next century.

We set our goals for the year 2000 because we know our economic health, our economic survival depends on how we educate ourselves to face the challenges a new century will bring. Tom and the thousands of men and women like him will help us meet those challenges.

Teachers know that real excellence demands commitment from everyone in every community as we work to create communities where learning can happen. It demands that talented men and women give time to become tutors and mentors. It demands that businesses, churches and synagogues and civic groups join together to support local schools. It demands that every citizen help his community develop a plan of action based on America 2000 and help the nation reach these national education goals.

Together, we literally will reinvent the American school community by community, neighborhood by neighborhood, all across this country. And at the heart of this shining new school will be, as always, the teacher.

Last week at the Oscars, George Lucas, filmmaker, might have captured it best when he thanked the teachers of his childhood. And he said, "All of us are teachers, teachers with very loud voices. But we will never match the power of the teacher who is able to whisper in a student's ear."

And so, Tom, on behalf of all Americans who have had the rare and priceless privilege of having a fine teacher whisper in their ear, congratulations. You teach the one lesson that matters the most: there's no distinction between who you are and what you do. You've woven the values of your life into your work. And thank you, sir. And may God bless you.

And now I have something special for you. This apple is the traditional symbol of teaching, and crystal represents the clarity of vision and commitment to the great teachers -- that the great teachers possess. And so, on behalf of a grateful nation, an admiring nation, with great pride in you, sir, congratulations.

Now, may I hand you this apple? (Applause.)

MR. FLEMING: Thank you very much. Mr. President, I accept this honor on behalf of the teachers of America, with your recognition of our commitment to teach every young person the challenges that they will need for the future. May God's strength be with you and His guidance as you lead our great nation. Thank you. (Applause.)

END 11:35 A.M. EST

THE WHITE HOUSE

Office of the Press Secretary
(Allentown, Pennsylvania)

For Immediate Release April 16, 1992

REMARKS BY THE PRESIDENT
IN ADDRESS TO SCHOOL COMMUNITY

Dieruff High School
Allentown, Pennsylvania

12:35 P.M. EDT

THE PRESIDENT: My fellow President, thank you very, very much. (Laughter.) This is a nonpolitical appearance, if there is any such thing in a strange political year. But let me just say this: I'm very glad that Hilda is not running for president this year. (Laughter.) And thank you for your introduction.

And may I congratulate all six of these guys that spelled out the six educational goals, reminding us of what our national goals are. And I asked one of them if he was nervous. He shook me off, said no. I don't believe him but -- (laughter) -- they did a first-class job, all of them, every one of them. (Applause.)

And may I pay my respects to our very able Secretary of Education Lamar Alexander; former governor, now challenging this country with America 2000, and doing a superb job for all the American people. (Applause.) And at my side in the United States Congress, caring deeply about education, telling me over and over again about the changes and the wonder that's taking place right here in the valley -- Don Ritter, your Congressman. He's doing a first-class job in Washington. (Applause.)

May I salute Mayors Daddona and Smith; the Mayor of Allentown and the Mayor of Bethlehem. And of course, pay my respect to Ed Donley, a driving force behind Lehigh Valley 2000 and Co-chair of Pennsylvania 2000. (Applause.) And my respect also to she who led us in the Pledge -- Ann Snyder, the valedictorian of the class of '92. Ann, thank you. (Applause.)

Our guests who did such a great job with the goals. Mike Meilinger, the Principal, and I thank him for calling this special assembly today and getting a lot of you out of class. You ought to be grateful to him. (Laughter and applause.)

My special thanks to the parents and the teachers and the staff. Thanks also to all the folks here from Allentown and Easton and Bethlehem -- the leading lights of Lehigh Valley. Last but not least, let me say hello to the students of Dieruff High, with special thanks to the band -- it was first-class music. Thank you all very, very much. (Applause.)

I don't know who is in charge of signs around this place, but they did a first-class job -- all through the building and everyplace else. (Applause.) And it's astonishing to be here with the Class of '92 as a graduate of the Class of '42. I realize the world I thought of as new -- for you, well, it's history.

But look now at the world you'll soon call your own -- at the pace of change that we've come to expect. Each day we see history played out in the headlines, literally. Old empires expire -- new worlds are born. In the past six months alone -- six months

MORE

-- we've seen the birth of 18 new nations. Who knows how many there will be by the time you take your big geography final a few weeks from now.

But the challenges we face -- the sheer complexity of our world -- cannot obscure the basic values that guide this nation. Times change, but truths, fundamental truths endure. I'm talking about the big issues that shape our world -- about the values close to home. Everything I've tried to do and done to preserve and advance three precious legacies: strong families; good jobs; and a world at peace. These are my goals. They should be all of ours.

Securing those legacies has been my mission as President -- and it's going to be my mission today and every day as long as I am President of the United States.

You know, right now here in Allentown and across America, the number one concern is the economy -- and turning this economy around, creating jobs is the mission that matters most. Listen to what people say about the economy. Get beneath the cold statistics -- get down to the real heart of this issue. People want to know whether they can keep the job they've got -- and whether they're on track for a better one. For their kids -- for each one of the students here today -- parents have got grander visions, great hopes. Not just a job -- a career. Work that means more than simply making ends meet; work that gives real meaning to your life.

People have a right to ask: what is government's role in all of this? No, we can't legislate the American Dream. But government can serve as a catalyst for change -- clearing away the obstacles to economic growth and the unnecessary costs of doing business. Expanding the opportunities for aggressive businesses, for enterprising individuals to create new jobs. Training and educating our children -- giving you the tools of thought you'll need to compete in this new, exciting world economy.

The fate of America's economic future rests on five key reforms: Free and fair trade -- our ability to break down barriers, open new markets to American goods. Our future rests on legal reform -- on ending the explosion of litigation that strains our patience and saps our economy. We're suing each other too much; we ought to be helping each other more. (Applause.) On health care reform -- opening up access to all Americans, controlling the run-away cost of health care without sacrificing choice and without sacrificing the best quality health care in the entire world. And then on government reform -- because only if we reverse a generation of creeping bureaucracy, and only if we restore limits to government can we restore public trust.

Finally, the reason I've come here to the Valley today: our future depends on education reform -- on our ability to revolutionize -- literally reinvent our schools. To take that revolution beyond the four walls of the classroom -- transform our attitudes and ideas, the way we think about education.

And I wish every adult and every kid could have been with me a few minutes ago as some of the leaders -- business and education leaders assembled, civic leaders, to tell me about this exciting change taking place right here in Lehigh Valley.

Education -- it represents a perfect community of interest -- between the individual and society; between one generation and the next; between the proud history we must pass on and the path-breaking future we must create. And in terms of America's economic future, education is nothing less than a matter of economic survival. It's just this simple: better schools mean better jobs.

MORE

You've seen the news stories. You've heard the statistics. Anyone who worries about slack productivity or a bad balance of trade ought to be alarmed about the test scores. Millions of students work hard; millions of dedicated teachers doing their very best -- and still, in one test after another, America's children score at or near the bottom ranks of international achievement. We don't need another test to tell us something is wrong with the state of American education. For the sake of every student here today, we've got to shake off any sense of complacency -- and have to shake up the status quo. (Applause.)

Now, in a sense, I'm preaching to the choir because here in Lehigh Valley, that's a lesson you learned long ago, years ago. But you didn't wait for word from Washington, D.C. You didn't stand back and watch another generation of kids get less education than they deserved. This community took a direct interest in what was going on in the classroom. This community came together; this community took action.

I took office determined to put the power of the presidency behind change. More than two years ago, we took a strong first step. Working together with the nation's governors, Democrat and Republican alike, we set six ambitious goals for the year 2000. It never had been done before: Every American child must start school ready to learn. We must raise the high school graduation rate to 90 percent. We must put in place a system of world-class standards and tests to measure students' progress. We must be first in the world in math and science. By the year 2000, every American adult must be literate, and every American school must be free of drugs, free from the violence that today too often follows our kids into the classroom. (Applause.)

Let me sum up the six goals this way: Together, by the year 2000, we must create the best schools in the world for our children. (Applause.)

Let me share a story that our Secretary, Lamar, told me about a little girl, a 4th-grader named Ariane Williams. At the kick-off for New Orleans 2000 down in Louisiana, she stood up -- and here's what she said: "These goals are not just the President's goals. They're not just the governors' goals. They are the nation's goals." That little girl got the message -- and so do you here in this Valley.

Goals define the mission. They tell us where we want to go -- not how to get there. That's why, nearly -- as I was reminded at this meeting I told you about -- nearly one year ago today, I mapped out a strategy I call America 2000: a plan to revolutionize American education. Then I heard the progress that had been made before that even began -- to break the mold and, for the sake of our children, put an end to business-as-usual.

Two days from now, we're going to mark the first anniversary of America 2000. Let me share with you today a kind of report card, if you will, on what we've accomplished. In one year's time, we've seen America 2000 literally catch fire all across this country. Already, 43 states and more than 1,000 communities -- from Grand Junction, Colorado, to Lewiston, Maine -- have joined the America 2000 crusade. Everywhere, people like you are working to break down the barriers between the classroom and the community -- to spark a grass-roots revolution to reinvent -- not just rework, but to literally reinvent the American school.

But you know that story because, once again, Lehigh Valley has led the way. (Applause.) I want to share with you an old African proverb that's the motto of Minnesota 2000: "It takes an entire village to educate one child." And that is what it takes -- because education doesn't just happen in the classroom. It doesn't

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start at 8:20 a.m. each morning and end at five of 3:00 p.m. All of us lead busy lives -- but we must never be too busy to read to our kids. And if I might ad lib something in here, I am very, very proud of Barbara Bush for setting an example about how families ought to stay together and how families ought to read to their kids -- parents ought to read to their kids. (Applause.)

And we must never be too busy to teach them right from wrong; to take an interest in the things that they worry about and wonder at -- and to listen, really listen, to what they say. We owe it to our children and to ourselves to see that we live in communities that care about education -- communities where learning can happen.

You've got every right to ask: What can Washington do to help? Well, here's one way we can. Today, I want to announce a new legislative initiative that I call the Lifetime Education and Training Account -- a package of grants and line of credit worth $25,000 dollars to every eligible American, to further their education or acquire new job skills to make the most of their abilities. I've said before if we want to compete in the 21st century, we've got to become a nation of students.

To do that, we've got to take a new approach to the old notions of "student aid." Think of the working mother, balancing her responsibility for her family and her job against her own hopes for the future. She'd take one college course at a time -- but she doesn't qualify right now for the grant or loan that would help pay tuition. Our Lifetime Education and Training Account would help her get back into the classroom. Here's the message for the students here today -- and for their parents: Education doesn't end with graduation. Learning has got to be a life-long pursuit.

I came to Lehigh -- to one of the first communities to join the America 2000 crusade -- to set the agenda for the second year of America 2000. Our next step forward depends on our success in building a consensus for change around four core ideas -- four ways to build on what we've begun, to transform the federal government into a catalyst for real education reform. First, if we're serious about reaching our goals, we must set world-class standards in five core subjects -- and establish a series of voluntary American Achievement Tests to measure our children's progress.

Second, we've got to grant states and local school districts relief from federal rules and regulations that limit their ability to improve educational achievement and do nothing to help us meet our national education goals. (Applause.) And parenthetically, I'm told by the leaders I met with today that the Governor of this state has granted such regulatory flexibility and regulatory relief to this community effort here.

Our teachers and our principals deserve flexibility -- freedom to use their front-line experience on what works best in their schools to meet these national goals. Has anyone asked the teachers here today: How can we ask you to teach -- and then tie your hands?

Third, we've got to launch a wide-open effort to create thousands of new American schools -- starting with at least one in every congressional district all across the United States. Right here in Lehigh Valley, you're hard at work on your plan to make this community home to its own New American School. I heard the exciting proposals on that today.

These break-the-mold schools won't conform to any one blueprint. Some may make a quantum leap forward into tomorrow's technologies. Others might seek to reach the future by restoring

older traditions, the discipline -- and disciplines -- of an earlier era. Each one of these schools would be a living example of how we can reinvent American education. All we need now from Congress is the seed money to help people like you translate ideas into action.

Fourth, we must create an incentive to improve education by promoting school choice. (Applause.) For far too long, we've shielded our schools from competition -- allowed the system a damaging monopoly-power over students. Well, just as monopolies are bad for the economy, they're bad for our kids. Every parent should have the power to choose which school is best for his child -- public, private or religious. (Applause.)

Look at our colleges, look at America's colleges. Look at the students. Our university system is the envy of the world. Each year, we make over $20 billion dollars in federal grants and loans directly to students -- one of every two students enrolled in college right now -- to use at the university of their choice. No one asks whether they enroll at Penn State, or Pennsylvania University, or Villanova, or Lehigh, or Lafayette. It's time we make the same choice available to all parents from the moment their children go to school. Whether it's the public school on your street or the one across town -- whether it's private, parochial, yeshiva or bible school -- let parents, not the government, make that choice. (Applause.)

And let's be clear: If we deny parents school choice -- if we deny that choice, let's recognize who's hurt worst by the status quo. It's not the well-to-do. It's not the rich guy. It's not the upper middle class. It's not any one of us who ever went house-hunting with a map of the good school districts. Deny people school choice, and the ones you hurt most are the middle class and lower -- and especially the poor.

That's why choice is catching on in some of the hardest-hit neighborhoods in this nation. Talk to parents that are spearheading the school choice crusade -- people like now famous Polly Williams in Milwaukee. They'll tell you how the lack of choice left them powerless to force change -- and how a public school bureaucracy turned students into statistics and parents into pawns. Look at Milwaukee today -- pioneering school choice, giving poor parents control, and poor children a sense of pride. Look at the schools closer to home -- East Harlem -- where teachers put their names on waiting lists to get a chance to teach in a choice school. They can't wait to stand in front of a classroom of children who want to be there -- who want to learn.

Choice works -- and here's why. When our students are a captive audience, our schools have no incentive to improve. Say what you want about reforming our schools, if you're for change, you are for school choice. These four ideas are generating interest and enthusiasm among governors and mayors -- Democrats, Republicans, liberals, conservatives -- among business leaders -- Ed Donley right here and the Allentown-Lehigh County Chamber of Commerce, to the Fortune 500. Among teachers and students and parents and principals -- everyone at every level who understands the need for change.

Everyone, that is, except the leaders of the United States Congress. At a moment when the consensus for change seems to be reaching critical mass, on Capitol Hill you can watch the last stand of the status quo. Forces there are waging a last-ditch effort to put the brakes on change -- to preserve the business-as-usual approach that brought us the present crisis in education.

The mind-set up on Capitol Hill reminds me of a letter I got the other day from an elementary school student -- a little girl named Haruka Abe: "I like," she says, "when my teacher reads my class some books -- because everybody gets sleepy." (Laughter.)

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Well, it reminds me of Capitol Hill and the way they're approaching change. (Laughter and applause.) Take a look at the bill that's now winding its way through the Congress -- the tired old ideas, tried and failed, that it wants to substitute for the four path-breaking ideas I mentioned a moment ago.

As part of America 2000, we asked Congress for authority to help develop world-class standards and America Achievement Tests; tools that would help us measure our students' progress; help families understand where their kids might stand and assess the return we're getting for our education dollars. And the status quo crowd up there on Capitol Hill said slow down to testing and standards. I asked Congress for funds for this New American Schools. Congress said no -- no to even funding one percent, 535 of 50,000 New American Schools that this nation needs.

They want to funnel more federal dollars into these existing mandated business-as-usual, state bureaucracy -- the very same bureaucracy that put us where we are today.

And we asked the Congress for flexibility for teachers, flexibility for principals. And Congress said no, let's stick to the status quo. And finally, we asked the Congress to fund pilot programs to promote school choice, programs to help poor families in six American cities. And Congress said no to school choice.

So today, let me just serve notice on the lobby, on the education lobby and their friends back on Capitol Hill: One year ago, I asked you to join with me in a revolution -- a revolution to be a part of America 2000. The time has come to get on board or get out of the way and stay behind. No more business-as-usual. (Applause.)

Congress can drag its feet, but it cannot stop change. Lehigh Valley is living proof of the words of the great Abraham Lincoln: "Revolutions do not go backward." There's a time early in every revolution when the status quo looks steady and strong -- and the forces that challenge it weak and without effect. And there's the moment when the forces of change carry the day -- the bankruptcy of the status quo stands revealed and the whole, hollow house of cards collapses.

The revolution in American education is already underway. In Lehigh Valley and in communities all across America, the old ways are being pushed aside, they're being abandoned; new ideas advanced. This revolution will triumph for the simplest and the strongest of reasons: because American parents want the best for their children. (Applause.) And also because there isn't a single child anywhere in the United States of America who doesn't deserve the best education possible. (Applause.)

From our schools to our courts, from our hospitals to the halls of government, from the neighborhoods outside our door to the realities of the new world economy, the need for reform won't wait. The only acceptable response is the American response. We must rekindle a revolution -- a revolution to bring change to the country that's changed the world.

The American people have made their choice. The American people want change. And you here in Lehigh Valley can proudly say, we are out front for fundamental, constructive change.

Thank you all for this wonderful day of learning, this warm welcome. And may God bless the United States of America. Thank you very much. (Applause.)

END 1:03 P.M. EDT

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release April 16, 1992

AMERICA 2000: First-year Accomplishments

FACT SHEET

On April 18, 1991, the President launched AMERICA 2000, a bold and comprehensive education strategy designed to mobilize the nation toward reaching six national education goals for the year 2000. The President was in Lehigh Valley, Pennsylvania today to mark the first anniversary of AMERICA 2000.

First-year Accomplishments

In just one year, AMERICA 2000 has helped establish a revolutionary new agenda for transforming education in states and communities across America. In virtually every state in the union, citizens are joining together in a remarkable partnership to revitalize American schools and improve the future of our nation and of our children.

- **AMERICA 2000 Communities**. Forty-three states (including Puerto Rico, American Samoa and the District of Columbia) and over 1,100 communities are organizing AMERICA 2000 initiatives in a nonpartisan spirit to improve education neighborhood-by-neighborhood, school-by-school.

- **World-class Standards**. The National Education Goals Panel and the National Council on Education Standards and Testing have moved rapidly to help create a consensus on what students need to know and be able to do in core subjects in order to lead productive and fulfilling lives in today's world. The Department of Education is supporting necessary research and development in support of standards and is seeking authority from Congress to do still more.

- **American Achievement Tests**. There is a new consensus about the need for a voluntary national assessment system that would measure student performance against world-class standards so that students, parents, teachers, policymakers and the community will know how their schools and students are performing.

- **Parental Choice of Schools**. This year, ten states gave parents more choices of the schools their children attend as a way to unleash competitive forces to improve all

schools. The President has already offered two legislative approaches to choice. The President is proposing a $500 million program to help states create their own GI Bill for children. A scholarship worth up to $1,000 would follow the children of low-and middle-income families to give them more of the same choices of all schools -- public, private, and religious -- that wealthier families already enjoy.

- **New American Schools**. The President sent to Congress a bill to authorize $545 million to help states create "break the mold" schools that will lead the way for other schools. The New American Schools Development Corporation was formed in June 1991, raised over $45 million, and received nearly 700 proposals from design teams to help create "break-the-mold" schools. Up to thirty of these proposals will be selected to receive design contracts by May 31, 1992.

- **Flexibility and Accountability**. The President has sent legislation to Congress to grant states the authority to waive outdated provisions of law that limit their ability to raise student achievement. Ohio, Texas, and 12 other states have given state commissioners of education broad authority to expand freedom from regulations for schools that set high goals and demonstrate results.

- **September Report Card**. In 1991, the National Education Goals Panel published the first annual September Goals Report providing a baseline against which to measure the nation's and each state's progress toward the six national education goals. Each year, these report cards will become increasingly powerful engines for change.

- **Federal Priority**. Education is the President's number one Federal budget priority. He proposed record increases for Head Start, for grants to help low- and middle-income families pay for college, and for university research and development. Much of the President's request for new funding supports his agenda for revolutionary change: New American Schools, school choice for families, standards and testing, and greater flexibility and accountability.

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release April 23, 1992

REMARKS BY THE PRESIDENT
TO ACADEMIC DECATHLON CHAMPIONS

The Rose Garden

11:18 A.M. EDT

THE PRESIDENT: Welcome all. And first, may I greet our distinguished number two over at the Energy Department, David Kearns, coming down here from a fantastic leadership role in American business to help us in this important America 2000 education program. So I'm delighted he's with us here today.

I want to salute the President and the Board of Directors of the U.S. Academic Decathlon -- all of them -- thank particularly all of the corporate sponsors who make so much of this possible. And also single out Danny Ramirez, Chris Roorda, and Greg Rudnick, standing up here with me today; salute the coaches and the friends. And most of all, a warm Rose Garden welcome to our newest American champs, newest American heroes, if you will -- the 1992 Academic Decathlon Champs, the team from J. Frank Dobie High in, yes, you guessed it, Houston, Texas. Now, where are they? Stand up. (Applause.) And they've got a good front-row seat, too. Thank you, guys, and welcome.

It's a great feat for my hometown -- the highest score, I'm told, in the history of the competition. And I'm very proud to welcome you all here. I hear that you wore "Rose Garden or Bust" pins. They work. And I'm wondering if you have an extra one for the fall. (Laughter.)

Congratulations also to our Silver and Bronze medalists from Mountain View High in Mesa, Arizona; Whitney Young Magnet High in Chicago; our regional winners from New Jersey, Alabama, Ohio, Nebraska and California; our small school winner from Wisconsin; and our 10 individual student scholarship winners -- nine from our top three winning schools, and then Mit Robertson here from Tupelo, Mississippi. Welcome all.

I want to send special good-luck wishes to those who will represent us at the International Decathlon in a couple of weeks -- the Academic Decathlon, that is. And since you're the star decathletes, tell me who is going to win at Barcelona -- Dan or Dave? (Laughter.)

You've all done something remarkable. And this year's contest began with 30,000 -- more than 30,000 students at 3,500 schools coast to coast. And now it's just you. And not only did you work all year to conquer environmental science in a range of 10 categories, you also survived the blizzard of 25,000 pieces of test paper out in Boise. And I was impressed by your Habitat Earth Super Quiz questions like this one: "In a molecule of methane, the carbon atom is at the center of what?" For you out there in the press -- (laughter) -- the answer is "a tetrahedron with four s-p-three bonds." Did you get that one down? I'll be glad to repeat the question -- never mind. (Laughter.)

That was easy. Not! Actually, pretty tough. But I know a category I could enter: computers. I was just in there with Secretary Kearns talking about it. I've been learning how to work

one because one of our education goals is that nobody is too old to learn. I wrote my first program a while ago. I'm not sure what happened to it. It was called "Michelangelo." (Laughter.)

Now, you kids here today represent every team member from across the country. And I want to tell you and them what all of you have done for America. You've shown that great things can be achieved by commitment, perseverance, hard work and, yes, teamwork. And I salute you, and I envy you. And you've found the sheer joy of learning, beginning to understand the world.

One day a scientist will discover the cure for cancer, the cure for AIDS. Other people will find new ways to feed the hungry. And there will be writers whose wisdom will touch lives. And right now, those men and women are kids in our classrooms or maybe even sitting right here in the Rose Garden.

Remember, study hard and one day one of you might grow up to be president. But let's face it, even then you'll never make as much money as your dog. (Laughter.) Millie, who normally comes to events like this, but she used to just roll over on the grass, and now all she rolls over is her money market account with -- in the street.

But, look, you've shown your peers that it is as exciting to root for an academic team as an athletic one. And that's a point I wanted to make for our entire country. You've shown that it takes skill, stamina and intensity to achieve in the classroom as well as in the stadium. And you've given them a priceless gift, your peers: the belief in their ability to reach out and shape their own lives.

There is a new century coming, one with absolutely unlimited horizons. And we must make sure all our children enter this new world equipped with the skills that will let them dream dreams and know they can make them come true.

One of the things that impresses me most about this Decathlon is that each team is made up of A, B and C students. And there's a great lesson there. What matters is simply that each kid be the best that he or she can be. As George Patton said, "If a man has done his best, what else is there?" We don't want the moon for our kids. We want something more important: a future.

And so one year ago, I unveiled America 2000, our long-range strategy to achieve our six national education goals. And it's a challenge posed to each of us in communities throughout America to literally reinvent American education. It urges us to reach deep within ourselves to find answers so that our kids can reach for the stars.

Changing our attitudes about education is too important to wait or waste a generation. To be competitive in this changing world, we must realize that we succeed economically at home; if we're to do that, we must lead economically abroad. Open markets, free trade, they mean jobs for American workers and economic growth for American companies. But we must be prepared to compete, ready to take advantage of these high-tech opportunities in the global marketplace.

We know our economic health, our economic survival, depend on how we educate ourselves to face the challenges of a new century. So we've set these six education goals to reach by the year 2000 -- when today's third and fourth graders will be taking part in this event, this Academic Decathlon by then -- and you all know these goals.

One of them, the first one: Our kids will start school ready to learn. That's more than Head Start. Head Start's a part of that. Our high school graduation rate must be 90 percent. The third

one: Our students will be achieving world-class standards. And then fourth: We'll be first in the world in science and math, a particularly important one. And then the fifth one: Every adult will be literate. No one is too old to learn. And sixth: Every American school must be safe, must be disciplined, must be drug-free. In other words, an environment where people can learn.

You will help us meet those challenges. Real excellence demands commitment from everyone as we create a new generation of American schools that demands more of the same choices of schools -- public, private or religious -- for middle class and poor Americans that wealthier families already have. Give them a chance to choose. It demands new creative partnership among parents, teachers, businesses and kids like the community involvement that encourages this Decathlon and the local and national corporate partnerships that fund it.

And by the way, I want to give a special note to the corporate sponsors with us today, whose leadership and vision make this Decathlon possible. This bond, really -- I referred to it earlier -- but this bond between industry and the individual is the keystone of the American spirit. The country needs to follow this decathlon's example in all these areas because for our future every citizen must now help every community develop a plan of action.

All ready 43 states and over 1,000 communities across this country have answered the call and have joined America 2000. This isn't Democrat or Republican or Liberal or Conservative. It is literally a move to revolutionize education. And together we are reinventing American education, neighborhood by neighborhood, community by community all across this country. And at the heart of it are you students, you kids, a new kind of campus hero. With the good values you learn from discipline determination. From a sharp mind that is not wasted on drugs and from the confidence and pride that comes from proving yourselves. And you will help this America 2000 dream come true.

For a great example of this we don't have to look further than a woman who is not with us today, D.C.'s Rhondee Johnson, a junior at Benjamin Banneker High who just won the National Academic Decathlon's Kristen Caperton Award for Inspiration and Courage. She takes her school responsibilities so seriously that she's helping her team at a track meet right now instead of joining us. And we all hope she wins the blue ribbon, but she's certainly winning it in life with her example.

Rhondee's lived with the tragedy of violence. When her aunt was killed, her four children came to live with Rhondee's family, making eight year-old Rhondee the oldest of nine kids in a single-parent household. She takes on a parent's duties and she still manages a 4.0 average. She is an inspiration, accepting responsibilities and challenges and still striving to excel.

She and all of you give a 1990's example of how Abraham Lincoln defined his own life when he said, "I do the very best I know how, the very best I can. And I mean to keep on doing so until the end."

I am proud of the message all of you winning decathletes send, that personal dedication, effort and teamwork lead to success. And when one of you bright young people solve the problem of who created "Michelangelo," just remember -- my name is Dana Carvey.

Thank you all very much for coming. Congratulations, and may God bless you all. (Applause.)

END 11:31 A.M. EDT

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, THE WHITE HOUSE
To: PRESIDENT BUSH (CC: AG.) ODD: NONE
Date Received: 04-22-92 Date Due: NONE Control #: X92042306308
Subject & Date
04-20-92 MEMO (COPY) REGARDING THE CALIFORNIA POLITICAL SCENE. PROVIDES THE PRESIDENT WITH A FEW OBSERVATIONS BASED ON HIS RECENT TRIP TO THAT STATE TO ADDRESS THE CALIFORNIA REPUBLICAN ASSEMBLY.

	Referred To:	Date:		Referred To:	Date:	
(1)	OAG;	04-23-92	(5)			W/IN:
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INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: MAU

20 APRIL 92

Remarks
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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B. Barr

CLAYTON YEUTTER

April 20, 1992

RECEIVED
DEPARTMENT OF ...

'92 APR 22 P 4:39

EXECUTIVE SECRETARIAT

MEMORANDUM FOR THE PRESIDENT

FROM: **CLAYTON YEUTTER** CY

SUBJECT: **CALIFORNIA POLITICAL SCENE**

You are already getting continual reports on the California political scene, but I wanted to add a few observations based on my trip to that state to address the California Republican Assembly.

As you will recall, this conservative group chose not to endorse anyone, but their straw poll went heavily to Buchanan. I wish I could have kept that from occurring, but they were in a mighty surly mood. Here's my analysis of all that, for whatever it may be worth.

First, we shouldn't draw conclusions from California based on the statements or actions of this group. Though it apparently has several thousand members, there probably were only 200 to 300 at the dinner event where I spoke. And that group might have been inordinately tilted toward Buchanan because he used the occasion to launch his California campaign. So the Buchanan folks undoubtedly made a special effort to get their supporters there. In addition, a lot of them came up to me after the event and said that even though they were unhappy with the Bush Administration and would be supporting Buchanan in the coming weeks, we could still count on them to support you and work hard this fall. Hence, it is clear not all of these folks will sit on their hands in the general election, but some of them might.

Why are they so unhappy? A good bit of this relates to their relationship with Governor Wilson, which is severely strained. Since the Governor has overall responsibility for your campaign in California, they hold you responsible for the actions and attitudes of the Governor and his staff. Many told me that the Governor was systematically excluding them from significant roles in your campaign, in the operations of the California Republican Party, and in the selection of delegates for the Houston convention. They are mad about all that. Jack Flanigan's selection to run the California campaign should help, and I'm sure the visit of Bob Teeter and Mary Matalin a couple of weeks ago was a big help too. I have a hunch that some of the Governor's staff people have been inordinately harsh, and perhaps even vindictive, with these folks, and they ought to back off. We need to have as many of these people with us this fall as we can get.

Second, they're very unhappy about illegal immigration, and they believe the Federal government is being unresponsive on that issue. That is one of Buchanan's big sales pitches, of course, so he had them all exercised while I was there. When I asked some of them what they thought the Administration should be doing over and above what it was now doing, they didn't offer much in the way of a response. The usual answer was "Just enforce the law for a change!" Some wanted the Administration to hire a lot more people in the border patrol, which is a little hard for them to justify while they are also condemning you for spending too much money.

Third, a lot of them seem very upset about crime and drugs, particularly in the schools.

Fourth, Buchanan had frightened them the previous evening about losing all their jobs because of the North American free trade agreement. I countered that vigorously, of course, but he is really poisoning the waters on that issue.

Finally, some of them commented that you were too soft on the Brady bill and other gun control issues.

Beyond the specific issues, I believe that Californians in general are just in shock over the state of their economy. Home values have fallen; commercial real estate values have plummeted; the defense industry is contracting; unemployment rates are substantially above the national average. They just find that impossible to comprehend because they thought it would never happen in California. For all practical purposes their economy sailed right through the 1982-83 recession, and I believe that most Californians had concluded that their economy was forever recession proof. They now know otherwise, and that has been a traumatic experience. They've returned from fantasy land to the real world, but they don't like it very much!

In addition, they are still disturbed that the President of the United States is no longer a Californian, and that you don't pay as much personal attention to them as did President Reagan. And they don't have Californians running the government as they did in the '80s. They were coddled during those years, when they got much of what they wanted from Washington, D.C. when they wanted it. That has now changed somewhat, even though a lot of folks in this Administration pay a whole lot of attention to California. They seek personalized attention from all of us, and it will be difficult to provide enough of that between now and November. But we should do our best.

There is also a lot of internecine warfare taking place in the Senatorial races, and that doesn't help. It generates

divisiveness within the California Republican Party, and we won't have much time to repair those wounds once the primary is over.

Bottom line: California is going to demand a lot of our time over the next few months, more than would ordinarily be the case. But I believe we should prepare, as an Administration, to commit that time--not only because of your race but because of the immense potential of winning California Congressional seats.

At the same time we ought to watch for opportunities to win other states that might not now be on our priority list. One sleeper state could be New York.

cc: S. Skinner
B. Teeter
R. Bond
R. Kaufman

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, COUNSELLOR TO THE PRES./DOMESTIC POLICY
To: AG.
ODD: NONE
Date Received: 04-21-92 Date Due: NONE Control #: X92042106195
Subject & Date
04-18-92 MEMO ATTACHING A COPY OF A PUBLICATION FROM THE HERITAGE FOUNDATION REGARDING THE AG'S ENFORCEMENT OF THE ANTITRUST LAWS TO FOREIGN COMPANIES IN FOREIGN COUNTRIES.
.
SEE EXEC. SEC. 92040905619 CONTROL SHEET ATTACHED.

	Referred To:	Date:		Referred To:	Date:	
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INTERIM BY: DATE: OPR:
Sig. For: NONE Date Released: CYN

1/8 APRIL 92

Remarks
INFO CC: ATR.
(1) ORIGINAL TO OAG FOR INFORMATION.

Other Remarks:

OLA CONTACT:

FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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THE WHITE HOUSE
WASHINGTON

DATE: ~~Apr. 18, 1992~~

TO: The Attorney General

FROM: **CLAYTON YEUTTER**
Counsellor to the President for Domestic Policy

Bill, I wouldn't lose any sleep over the attached. First, the Heritage folks seem determined to be critical of the Administration these days. They're going to be in a pretty embarrassing position when the President is re-elected.

Second, you and Jim did the right thing on this issue. I'm convinced that it constitutes another step forward in dealing with the Japanese, and I firmly believe that most Americans who understand the issue would agree with that.

CY

cc Sam Skinner

Executive Memorandum
The Heritage Foundation
214 Massachusetts Avenue, N.E. Washington, D.C. 20002-4999 (202) 546-4400
RUSH!
4/10/92 Number 327

THE DEPARTMENT OF JUSTICE: APRIL FOOLISHNESS ON ANTITRUST

George Bush was correct on January 28 to declare a 90-day moratorium on new federal regulations and to instruct federal agencies to assess the harm done by existing regulations to the American economy. But Attorney General William Barr now has violated the spirit if not the letter of this ban. Last week he changed the Justice Department's enforcement guidelines to extend the reach of United States antitrust laws, which restrict business cooperation, to foreign companies in foreign countries.

Attempting to enforce antitrust laws overseas is a bad policy on its merits. These laws make American firms less competitive. Trying to enforce them beyond America's borders invites retaliation from trading partners. But as bad as that is, worse is the appearance that Bush is not in control of his own cabinet. If he wishes to shed the label of the "reregulatory President" that he so far has earned, he must instruct Barr to reverse this decision and instruct all federal officials to abide rigorously by his moratorium and to review regulations thoroughly as a prelude to a major deregulation effort to make America more competitive.

Antitrust laws allow the federal government to prevent cooperation between businesses that it believes will unduly restrict competition. Justice Department guidelines have allowed enforcement of these laws against foreign companies operating in their own countries only if American consumers are harmed by such collusion. But there are rarely overseas applications of these laws since American consumers usually gain better quality products at low prices from cooperation between foreign firms. Barr now has eliminated this "American consumer" provision, thus opening the door for more extensive Justice Department action against foreign firms.

To begin with, antitrust laws are of questionable economic benefit. The premise behind these laws is that close cooperation between businesses will result in monopolies which restrict competition and force consumers to pay higher prices for goods and services. Even if this is sometimes true, cooperation often allows businesses to turn out better quality products at lower prices. By stifling even beneficial cooperation, America's antitrust laws all too often make American firms less able to compete against foreign competitors that are not subject to such harmful laws by their own governments.

Legally Dubious. An attempt by the U.S. to apply its antitrust laws to foreign companies operating in their own countries in accordance with their countries' laws is legally dubious. As the U.S. Supreme Court emphasized in the 1986 case of *Matsushita Electric Industrial Co. v. Zenith Radio Corporation*, the cartelization of a foreign market cannot violate U.S. antitrust laws, "because American antitrust laws do not regulate the competitive conditions of other nations' economies." While a case under the new Justice Department guidelines might raise somewhat different issues, the basic issue would be the same, and the Court might well strike down these guidelines.

An attempt to enforce American antitrust laws overseas also would be impractical. The Justice Department would have to act against an American-based subsidiary of the foreign firm. The subsidiary would be required to defend itself in a U.S. court for the actions of a parent company, franchiser, or partner. In such prosecutions the U.S. government would not be able to provide due process of law for the accused. How exactly, for example, would the Justice Department accumulate evidence, since its agents generally cannot operate legally in foreign countries? How would the Justice Department subpoena evidence from overseas firms, since its jurisdiction does not extend to foreign countries?

Invitation to Retaliation. An attempt by the Justice Department to enforce American antitrust laws overseas invites retaliation. The European Community (EC), for example, might prosecute America's Ford Motor Company's European subsidiary because workers in a Ford factory in Michigan are not accorded the benefits mandated by EC labor laws. The EC could claim that lower benefit levels for Ford workers in the U.S. are a form of "unfair" competition against European auto manufacturers. The EC would not accept as a defense that Ford's European factory treats its workers according to EC laws. In such a case the American government and people correctly would consider the EC's behavior an unjustified attempt to meddle in U.S. internal economic and political matters.

Although the Justice Department insists that the new policy is not aimed at any one country, Barr's change in antitrust enforcement guidelines seems to be aimed mainly at Japanese companies that often operate in strategic alliances called "keiretsus." But if the Justice Department targets Japanese firms, it is likely to hit American firms as well. American companies now are breaking into the Japanese market by joining in such strategic alliances. Example: Last October the Aluminum Company of America and Japan's Kobe Steel established an alliance to produce tubing for photocopiers. Example: Last December America's International Business Machine Corporation and Japan's Canon Ltd. announced plans for joint production of notebook computers. Example: In January of this year American Telephone and Telegraph and Nippon Electric Company agreed to manufacture jointly dynamic random access memory chips. As American firms use such alliances to become more competitive and to penetrate foreign markets, they could find the U.S. Justice Department frustrating their efforts in an attempt to apply America's antitrust laws overseas.

With his announcement of a 90-day moratorium on new government regulations, Bush acknowledges that federal regulations often do more harm to the economy than good, crippling American firms in their ongoing contest with foreign competitors. A so-called "level playing field" should not consist of applying the same destructive regulations to overseas firms, crippling them as well.

Freeing Business. If the Bush Administration is serious about freeing American enterprise from the burden of regulations, the President must get control of his own officials and demand that they obey his 90-day moratorium. To untie the hands of American business, the Administration should seek to amend U.S. antitrust laws to make it easier for American firms to form joint ventures, both with one another and with foreign firms. And as a first step in this effort, the President should instruct Attorney General Barr to abandon any attempt to apply American antitrust laws to acts taken by foreign firms on foreign soil.

Edward L. Hudgins, Ph.D.
Walker Fellow in Economics
Deputy Director of Economic Policy Studies

Nancy Bord, Ph.D.
Bradley Resident Scholar

For further information:

Bryan Johnson, "Forging Alliances to Bust Into the Japanese Market," Heritage Foundation *Backgrounder* No. 876, January 31, 1992.

DEPARTMENT OF JUSTICE
EXECUTIVE SECRETARIAT CONTROL DATA SHEET

From: YEUTTER, CLAYTON, THE WHITE HOUSE
To: MALOTT, ROBERT H., FMC CORP. (BCC: AG.) ODD: NONE
Date Received: 04-21-92 Date Due: NONE Control #: X92042206223
Subject & Date
04-17-92 NOTE (COPY) THANKING MR. MALOTT FOR HIS LETTER REGARDING A RECENT COLUMN BY PAUL GIGOT IN "THE WALL STREET JOURNAL" REGARDING CIVIL JUSTICE REFORM. ADVISES THAT THEY HOPE TO GIVE THIS ISSUE MORE VISIBILITY IN THE CAMPAIGN.
.
NOTE: ARTICLE NOT ENCLOSED.

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	Sig. For:	NONE		Date Released:		MAU

17 APRIL 92

Remarks
INFO CC: DAG, ASG, CIV.
(1) FOR INFORMATION.

Other Remarks:

OLA CONTACT:
JRH 4/22/92
FILE: WHITE HOUSE CORRESPONDENCE/GENERAL

REMOVE THIS CONTROL SHEET PRIOR TO FILING AND DISPOSE OF APPROPRIATELY
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THE WHITE HOUSE

WASHINGTON

Apr. 17, 1992

[redacted]

To Bob Malott

Bob, the Gigot column was excellent. It has gotten a lot of attention here and elsewhere. He's an excellent journalist.

Civil justice reform is one of the five "pillars" that are now the centerpiece of the President's speeches. And, as you know, the Vice President has worked that issue beautifully for several months.

[redacted]

We do hope to give all this more visibility in the campaign, though it may not fit the schedule for a while yet.

Thanks for taking the time to write. Our best to Ibby and the FMC crew.

'92 APR 21 P5:03

Clayton Yeutter

[redacted]

bc:
S. Skinner
H. Moore
M. Fitzwater
~~B. Gray~~
B. Barr
R. Porter
C. Kolb
B. Anderson
E. Holiday

Robert H Malott
Chairman of the Executive Committee

FMC Corporation
200 East Randolph Drive
Chicago Illinois 60601

April 14, 1992

Honorable Clayton Yeutter
White House Counselor for Domestic Policy
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Clayt:

Because of my long-standing interest in tort law reform, I was interested in the column by Paul Gigot (article enclosed) in the April 10 issue of The Wall Street Journal. You'll note it concludes with a suggestion that the President might make this a higher visability issue during the campaign. I would endorse his doing so!

Sincerely,

Bob

Robert H. Malott

Encl.
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